NEW MONEY FOR NEW MEN

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BY

S. S. METZ

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DEDICATION

To the ever-growing fellowship throughout the ages of deathless Christian men and women, humble and exalted, whose lives are consecrated to the service of God, and who in their tender devotion and selfless love for their fellow-creatures reflect the spirit of His dear Son, this little volume is reverently dedicated.

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AUTHOR'S NOTE

I HAD thought of describing myself in a sub-title to this book as " a banker who believes in God ", but it occurred to me that this might be interpreted as implying that belief in God is rare amongst bankers. The purpose I had in mind was to make it clear from the outset that God, and all that acceptance of Christian doctrines should mean in the social relationship of men, will not be ignored in these pages. To those potential readers, therefore, who hold that the spiritual and material aspects of life do not mix I would say, " You have been warned ! "

My banking career extends over close upon thirty-five years, of which nearly thirty have been spent here and in the United States and in travel overseas. It has given me exceptional opportunities for the practical study on the spot of financial systems and economic problems throughout the world.

My investigations and reflections have led me to the conclusion that there are glaring defects in the mechanism of money and in its exploitation by man. Moreover, chained to a base of gold, sterile and soulless, it is subject to influences alien to the material welfare of the community, and apt to accentuate, where they do not originate, recurrent economic depression.

In so far as the banking system under the present order is compelled to permit the money which it creates to be used by its owners as a store of value—idle deposits—it is placed in a position of condoning, nay, facilitating and encouraging, the pursuit, albeit unconscious and semi-automatic, of policies which will be revealed as inimical to the common weal.

The combined effect of the inherent shortcomings of the financial system, of its misuse by man and of the absence of protection against the evils of unbalanced production and

international financial and economic relationships, is the dreaded trade cycle, in turn responsible for that scourge of modern civilisation, that ghastly indictment of our much-vaunted civilisation : unemployment. Unemployment in a world craving the endless variety of products which the labour of those now idle could provide !

Any solution of that agonising problem, to be permanent, must therefore provide for a reform of the monetary mechanism. That reform must go hand in hand with a new order in the conduct of man's dealings with his money and of the whole complex of the exchange of goods and services. It must be inspired by an altogether new outlook on our economic problems. It must be based on the unshakable determination that all available man-power and means of production shall be utilised to the fullest extent, and without delay, in such directions as will result in the greatest material well-being of the community.

To answer these requirements the financial system must be stripped of influence over the purchasing power of money and freed from the fetters which, by preventing untrammelled adjustability to credit demands for genuine trade purposes, conduce to the periodic disturbances that mark our present economic order. Moreover, every possibility of the utilisation of money in ways disruptive of the continuity of the flow into goods and services must be eliminated.

In this book I have outlined proposals that will achieve these aims. It has been my purpose to make it intelligible to the layman.

It is divided into three parts. The first gives a brief description of the inner working of that complicated and delicate machinery designated by the general term of " money ".

In the second, the significance of the principal features of a money economy in its domestic and international aspects are analysed. Profits, interest, investment, saving, foreign exchange, external trade, balance of international payments—who has not sensed their potent, yet elusive, influence on the material fortunes of the community ? I

have selected our own financial system for the purpose of my analysis. In view of the similarity of the principles underlying all systems, however, much of the comment has universal application.

The third section submits proposals for a new order. The new order is based on a state in which economic activities are conducted on planned lines, as they must be wherever the well-being of the whole is placed above sectional interests.

The proposals I put forward are far-reaching. They are submitted in the full conviction that, failing a solution on some such lines, the system cannot endure. No facile expedients are suggested, such as gratuitous creation of purchasing power, which in the last analysis is but an ingenious form of self-deception. Panaceas I have none to offer. The choice lies between enlightened acceptance of restriction of freedom in certain directions, self-imposed after thorough investigation, and submission to the withering blight of crude political domination based on ignorance and class hatred. Those who believe that this latter contingency is imaginary live, I fear, in a fool's paradise. They should remember the wit's definition of democracy: " The right of every man to make everyone else suffer as much as he does ". Of that right full use will be made, unless we avail ourselves, and that promptly, of a right more valid and meritorious in the sight of God, the right to insist upon everyone having the same privileges as we enjoy ourselves, and to see that no one abuses them. It is no coincidence that the most glaring failures of the system occur in the very directions in which it permits violation of the divine laws.

If a study of the material submitted in this volume can lead to action designed to bring our economic order into harmony with that Spirit which has been revealed to mankind as the divine conception of human relationships, it will not have been written in vain.

March 1938

INTRODUCTION

THERE is a vital connection between the subject of this book and the spiritual aspect of existence.

A definite order has been assigned by our Lord to our material interests. He says : " Seek ye first the Kingdom of God and His righteousness, and all these things shall be added unto you ". We in our wisdom have inverted His order, and in flagrant disobedience to His word have made the cult of the material paramount.

The punishment we have brought upon ourselves by our perversity we realise in its grim tragedy when we look at the world around us. Hatred, jealousy, covetousness, evil passions of every kind are rampant, and such is the dominion they have gained over the spirit of man that he shrinks from no crime individually or collectively to achieve his ends, whether directed against opponents within or without the national boundaries. Hence the peace of the world is in jeopardy.

Amidst the welter and confusion in the political domain, orderly economic existence has disintegrated. A growing sense of insecurity in the financial realm is widely prevalent. In more than one country insolvency looms. Tampered with and coerced into artificial channels, the springs of that fructifying stream of interchange of goods between the peoples of the earth have been impoverished, endangering the lives of millions of human beings through the wasting of the bounties of God's earth.

Is there then no answer to the progressive demoralization which we see spreading around us ? Are we to await with folded arms the impending doom ?

Christians believe and incessantly pray that God's ways, as revealed by Christ, will ultimately prevail in this world. But faith and prayer is not enough. Our spirit is so frequently typified by the child in *Punch* who was kneeling

by his bedside, and when asked by his Nanny what he was praying for, answered: "I want Pekin to be the capital of Greece, 'cos that's what I've put in my school paper"! We expect God to prosper our own aims which we parade as His will.

We may feel too that, as individuals, it is hopeless to attempt single-handed to stem the tide of godlessness and materialism. We are so easily persuaded that our puny efforts will be wasted, that our feeble voice could not be heard in the desert of unbelief and libertinism. The helplessness of the individual is perhaps even more acutely felt in regard to the financial and economic structure, because of its complicated and technical character. He is caught up in a machine grinding away impersonally and relentlessly, of the workings of which he has but a vague conception, though he is aware of the havoc it wreaks.

Moreover, have we not heard the wiseacres of this world proclaim solemnly that "human nature cannot be changed"? And solemnly the listener sighs: "Alas!" and nods assent to wisdom that seems irrefutable. Interpreted, this statement is intended to convey that both motive and the human response it evokes are not merely irrevocably fixed, but will for ever continue on the low plane to which our carnal nature tends. When thus exposed in its true character the assertion is a direct negation of the wisdom of God. Not only did Christ work on this earth solely in the divine knowledge that the human spirit *could* change, but He made it absolutely clear that it was an indispensable preliminary to perception of the divine truth: "Verily, verily, I say unto thee, Except a man be born again he cannot see the Kingdom of God" (St. John iii. 3). Motive and response will ever be a true reflection of the extent to which we are prepared to place our nature under the direction of the Spirit with which we have been endowed by the Creator. When that spirit is given full sway our outlook upon the wider problems that surround us changes. We could not be complacent with millions of unemployed around us. We would come to look upon poverty in our midst and the moral disintegration attendant

upon enforced idleness not merely as an economic perversion, but as a most flagrant manifestation of lack of love for our neighbour—a breach of that great commandment which Jesus proclaimed to be indissolubly bound up with love for God.

No plan, however truly conceived, no legislation, however beneficent its aims, can be effective unless our outlook upon the material problems of this life is brought into harmony with the loving Spirit of the Creator, to which we owe life itself, and that directs and governs every aspect of existence. Only when that attitude prevails may we hope to escape the fate that threatens to overwhelm us, and begin to approach the solution along lines that can lead to a better world. No lesser vision can guide us.

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SECTION I

INSIDE THE FINANCIAL SYSTEM

"When we understand—though not until then—we are in a position to control, to plan and to change."

JOHN McMURRAY
in *Interpreting the Universe*

CHAPTER 1

MONEY ECONOMICS

THE devastating influence of Mammon on the soul of the world has caused Christians to doubt whether a money economy is in its essence compatible with the will of God.

It is undeniable that some of the most pernicious features of our modern world could not have developed except for a money economy. On the other hand, it is equally certain that, without it, material progress could not have attained its present level. I venture no judgment on the value of these achievements in the sight of God. Nevertheless it seems to me that there can be no joy in Heaven on this score, if increased material well-being is merely incidental to selfish striving, and if the distribution of these worldly bounties—with which God provides us—is not governed by that spirit of loving care for all His creatures which alone is acceptable to Him. Jesus nowhere denounces gainful activity, but he assigns to it the place which God desires that it should occupy in our lives, and He shows us the attitude of mind and the motives that should govern us in its pursuit.

To the extent that the financial system facilitates the conduct of that vast and infinitely varied mass of transactions involved in the process of production and interchange of goods and services, it is difficult to see how there can be any inherent conflict between its functions and the Christian faith. Rather may we detect in some of the features of the smooth and efficiently working organisation evidence of God-directed ingenuity and inventiveness. I do not believe that there is a workable substitute.

It is necessary, however, to distinguish sharply between those mainly mechanical and semi-automatic activities of the system that second and promote the process of production and distribution, and others which have been

forced upon it by the all-devouring urge in Man to enrich himself. The former consist in the supply of circulating media, the clearing of current transactions, and the satisfaction of the need of credit for self-liquidating purposes.

Even in this sphere the system suffers from grave defects. They arise from the fetters Man has imposed on the system by placing it in vassalage to gold. It may not be generally recognised that, in spite of our being " off gold ", our currency and the whole of our credit system continue to be linked to gold to a degree more complete than in many so-called gold countries. This connection impairs the freedom of those in control of financial policy in the adjustment of the machinery to expanding credit requirements, imposes upon the system considerations unconnected with the financial requirements involved in the productive activities of the country, and frequently forces it to take action which accentuates the very trends that needed to be counteracted.

Significant though this subservience to the dominion of gold may be, and deeply rooted in human nature its origin, it is chiefly a problem of money mechanics and might be made to yield to the reorganising skill of financial experts were it not that the link with gold extends beyond the confines of the domestic financial domain into the international sphere. Ultimately gold is the only means by which settlement of balances in international payment account can be effected. Hence the statesman no less than the expert is involved and reform must take cognisance of the whole range of problems surrounding the foreign exchanges, foreign investment, foreign trade and invisible items in current economic and financial intercourse with foreign countries.

In the realm of man's dealings with money—as distinct from the technical aspects of money economics—it is likewise indispensable that the legislator and the financial technician should closely collaborate. The abuses to which the present system gives rise are twofold in character: deliberate and involuntary.

The former, which in the main consist in the use of

money borrowed from the financial system for speculative purposes, are generally recognised to be detrimental to the public welfare, though the man in the street may be unaware of the exact nature of the damage capable of being inflicted. In any case it should be a relatively simple matter to check practices of that type.

It is different, however, with the involuntary misusings of the system which arise from the very constitution of money economics under the present order. In our daily contacts with what we are wont to consider " our money ", we constantly effect transactions perfectly harmless in our conception, which nevertheless are prejudicial to the community and, in the aggregate, ultimately encompass the periodic breakdown of the process of interchange of goods and services, often termed trade—or cyclical—depression.

It is in the manner in which surplus income of the individual, and undistributed profit of enterprise, is dealt with that the danger lurks. Profits, deposits, savings, investment, will require our careful study.

It would be futile to expect, however, that, even if the public were fully enlightened on the subject, and appreciated the true import of every transaction connected with surplus income, the vices inherent in the present order could be effectively overcome without comprehensive legislation to enforce upon all abstention from acts harmful to the common weal. Failing this, innate greed and callous disregard of the interests of others would defeat the scrupulous observance of policies conducive to the public welfare by those who had the prosperity of their fellow-beings at heart, even if these latter were in the majority.

Finally there is an aspect of money economics which is necessarily inherent neither in the technical organisation of the financial system nor in the dealings of the public with their surplus income, but which nevertheless in practice plays a vital part, both in the upward and downward swings of the trade cycle. I refer to the power of the financial system, under the present order, to take the initiative in expanding or contracting the volume of money by so-called open market policy. Its reactions upon the body

economic are so far-reaching, its control under our present régime is so completely divorced from the influence of the community, that we are bound to submit it to critical consideration in all its ramifications. It will be for the elected representatives of the people, in the light of the conclusions to which we shall be led, to determine whether an end should be put to a prerogative of which the exercise produces repercussions upon every phase of our national existence.

It is clear, in view of the fundamental connection between the working of money economics and the whole of our social fabric, that it would be futile to endeavour to deal with it piecemeal. Elsewhere it has been attempted to correct *some* of the objectionable features of the system without a co-ordinated plan for tackling the entire structure. That policy will be found ineffective in the long run. Patchwork cannot avail. It is inacceptable to God and man. " No man putteth a piece of a new garment upon an old ; if otherwise, then both the new maketh a rent, and the piece that was taken out of the new agreeth not with the old " (St. Luke v. 36).

Reform must eliminate all features which impede or obstruct the adaptability of the system to the planned needs of a community geared to the fullest employment of all its productive forces. Every loophole which enables the system to be used for purposes alien to the public welfare must be stopped. The freedom of the individual in the conduct of his financial affairs must be restricted, where its exercise consciously or unconsciously clashes with the true interests of his fellow-beings.

There are some who would smash up the entire system, believing that by shattering Mammon's throne they can render him impotent. Alas, his worshippers would not tarry in building him another shrine.

Without a doubt our present order is defective, but at the root of the problem lies the attitude of man towards his fellow-beings. Contemptuous of divine revelation, insensible to his obligations towards his Creator, he does not trouble to enquire how his actions affect his brethren, but

thoughtlessly acquiesces in established customs and follows accepted tenets so long as his own immediate pecuniary interests appear to be served. I say "appear" advisedly, for no order can permanently prosper in which the fundamental duty to the community is neglected by the members. George Herbert's words addressed to Gold in his little poem "Avarice" are more true to-day, applied to money in its wider sense, than ever they were: "Thou art the man and man but dross to thee". When the lives of our fellow-beings are at stake thoughtlessness is a crime!

CHAPTER 2

THE THREE FUNCTIONS OF MONEY

BEFORE considering the features of our financial order in their bearing upon the body economic, a few general observations on the functions of money may prove helpful.

We use the term " money " to cover " currency " (Bank of England notes) and " bank money " (bank deposits) collectively. We ignore " token money "—or " change ", as it is colloquially called—of which the aggregate in circulation is relatively unimportant, and the creation of which is governed solely by the convenience of the public. Strictly speaking, we should include under money " book credit " granted by members of the community to each other. There are no data available as to the outstanding volume of this type of " money ", but the bulk of it is directly connected with the turning over of goods and services. It is not subject to influences that could occasion changes in its quantity unrelated to changes in the turnover and price level of goods.[1] As we are here concerned with those *monetary* factors which themselves influence the price level and turnover of goods, we need not take book credit into consideration.

Money fulfils a triple function. It acts as a medium of exchange, a measure of value and a store of value. It would not be possible to conceive of any instrument conforming to our conception of money which did not possess all three attributes in combination. Yet there is an inherent conflict between two of them. The same money, as we shall see, cannot adequately fulfil its role as a measure of value and itself serve as a means of storing up purchasing power.

What are the characteristics that distinguish money in each of these three functions?

[1] Unless otherwise stated, the term " goods " is always intended to include " services ".

As a medium of exchange, money is required to afford a convenient and universally acceptable means of settling the infinite variety and mass of current transactions involved in economic intercourse of mankind. It must be freely and promptly exchangeable for goods — in other words, it must represent purchasing power and must be immediately available for use as such.

Public confidence in the assets underlying the money and ready transferability are the essential conditions which enable money to function as a medium of exchange. The money we know—currency and bank money available by cheque—fully meets these needs.

Distinct, though inseparable from the task of providing a medium of exchange, is that of measuring the value of the things exchanged. In the realm of value nothing can be specific or constant. Value is the fourth dimension in a three-dimensional world. We have no conception to fit it, no absolute terms in which to define it. It is a relationship expressing the thing to be measured in terms of something else which itself has meaning only when related to the very objects whose value it determines.

In " money economics " goods are valued or measured in terms of units of money which are part of an ever varying aggregate.

A true measure of value, if such could be contrived by human agency, should operate so that it registered changes in the value of the assets to be measured from causes inherent in or directly associated with the assets or with the impact of human initiative upon them. The measure should not be capable of being itself a factor affecting the value of the assets or of influencing the forces governing human initiative. A true measure would legitimately reflect, for instance, changes in volume of crops, fresh discoveries of minerals, reduced mineral yield, vagaries of public taste and habits, new inventions, political fears, confidence, increased wages, higher dividends. On the other hand, it should not have power, by altering the total number of units of the measure, to affect the relationship between the measure and the assets to be measured.

Under our existing order this fundamental requirement of a measure of value is not fulfilled. At the will of the financial authorities the measure is subject to expansion or contraction, independently of, inversely to, or in different ratio from that which would have resulted if the forces inherent in the assets to be measured and in the initiative of the community, apart from purely monetary factors, had alone determined the volume of money created.

The implications of this defect are far-reaching. The repercussions upon the value of goods and services produce grave distortions in the body economic, which, in combination with other nefarious features of the conduct by mankind of its material affairs, must be held responsible for the social and political disintegration in process throughout the world.

Money comes into play as a measure when assets actually change ownership. Simultaneously, as a counterpart, the transfer of a corresponding number of units of the measure itself is agreed upon, to take place either before or after or against delivery of the assets. Thus the function of money as a medium of exchange and as a measure of value cannot be physically separated.

Since the measure is valuable in itself by virtue of the assets which underlie it, it will be appreciated that the notion of money as a mere counter or yardstick is inadequate. In so far as a counter is merely a substitute for money, the description does not clarify our conception of the measuring functions of money, whilst yardsticks, not being themselves exchangeable for other assets, lack the essential attribute of money. As already indicated, it is not practicable by a simple and familiar analogy, derived from daily life, to illustrate the idea of value as it applies to money. If we could imagine a society in which the actual weights and measures used were the money of the country, were all made of the same substance, bore a definite relationship to one another, whether measures of dimension, weight or capacity, were issued by one Central Authority for valuable consideration including the substance of which they were made, were a coveted possession for their own

sake because of the substance of which they were made, and were the only valid medium of payment so that weights or measures actually changed hands every time a transaction was effected, each bargain thus involving as much a purchase or sale of the weights and measures as of goods and services or other assets, then we would be approaching to a state of affairs akin, in its essence, to an elementary money economy. I will not alaborate the comparison, but it may be found helpful towards an understanding of certain of the more puzzling aspects of money economics.

Under the prevailing system the financial authorities can at will increase or contract the number of units of the measure in existence, but the valuable consideration which they acquire or dispose of in taking this initiative is confined to a limited range of assets, viz. securities and bills of exchange. The price level of these groups of assets only can thus be *directly* influenced by the money authority, but the effects upon the price level of goods and services is none the less potent because it is indirect.

Money is called upon to measure two main groups of assets: current goods and services on the one hand and existing capital assets on the other (existing securities and buildings and land). Since an increase or reduction in the total number of units of the measure can be effected by the system unassociated with any initiative arising from the volume or turnover of goods and services, and since units of the measure once owned by members of the community can be used indiscriminately for the measuring (acquisition) of goods or of existing capital assets, it is clear that the mere autogamous increase or contraction of the total volume of money opens up potentialities of changes of monetary origin in the price level of assets of either group.

What are the reactions set in motion by the initiative of the financial authorities, and what, in practice, is the mechanism by which they operate, will be described in subsequent chapters. Here I would draw attention to the importance, from the point of view of the price trend, of the direction from which the initiative in the measuring

function preponderantly emanates. We have seen that it is both assets and units of the measure which change hands. If the call to exchange predominantly originates with owners of units of the measure, then the assets which it is sought to acquire in exchange will tend to appreciate in terms of the measure; goods or capital assets, or both, as the case may be, will rise in price. If, on the other hand, it is the owners of assets that actively seek to divest themselves of their holdings in order to obtain units of the measure, the latter will tend to become more valuable—and the price level move downward. In a state of equilibrium neither side would be especially prominent. This looks like stating in rather involved terms the simple law of supply and demand. We are, however, accustomed to associate this law solely with goods and services or other assets, and are apt to overlook that the powers at present vested in the financial system produce variations of supply and demand for units of the measure, which themselves are in turn responsible for affecting supply and demand in goods and other assets.

There is yet another facet of the measuring function of money which deserves comment. Money is used not merely to measure present assets or services, but to fix the price of assets yet to be created. This happens when, for instance, commodities are purchased for delivery at some future date remote from the present. The remuneration which capital supplied on loan (interest), and capital assets supplied on lease (rent), are to receive throughout the future period for which such operations run is likewise fixed in money.

In the case of transactions for future delivery of goods, the contracting parties cannot be under any misapprehension as to the risks involved in their bargain. On the other hand, the true import of commitments for future performances solely expressed in money tends to be obscured by "money economics", which have caused money, in the mind of the average member of the community, to become divorced from goods. It is not adequately realised, in consequence, that changes in the relationship

between the measure, on the one hand, and assets, on the other hand—in other words, changes in the price level—may gravely affect the position of debtors whose obligations are fixed solely in terms of the one (money) and who are dependent upon the price level of the other (assets of any description) for the means of meeting them. This is true with particular emphasis where the commitments are entered into at a time when, comparatively speaking, money in terms of assets is cheap, that is, when the price level is relatively high and where those commitments run for long periods of years (mortgages, long leases, long-term borrowing). When, in the brief space of a few years, the measure, in terms of goods and of capital assets, becomes twice, and in some cases three or four—exceptionally even up to ten—times, as valuable as previously, as was the recent experience of the world, universal insolvency of such debtors becomes inevitable. Moreover the desire, under such conditions, to carry out these fixed money commitments, or the attempt to enforce them, produces an aggravation of the very conditions responsible for the debtors' plight. It will involve the urgent pressure of goods and capital assets for sale against units of the measure, at a time when the latter is already appreciated manifold in terms of the things it is called upon to measure, and when the initiative in the measuring process lies one-sidedly with those having assets which they seek to exchange for money.

The position of mortgagors of farm lands in the United States, and, to a lesser extent, in this country, resulting from the collapse in prices of farm products, the defaults in international loans which have become widespread, the plight of industrial enterprise heavily burdened with fixed charges, are glaring examples of the havoc wrought by the impact of fixed money obligations amidst an order in which the relationship between that money and the things to be measured—goods and capital assets—is subject to violent changes.

A workable substitute for money as a means of expressing the remuneration for the loan of capital in one form or another, is not available. Our course lies in the

direction of working for an order from which, on the one hand, all elements of instability of price level arising from tampering with the measure shall have been eliminated, and which, so far as human planning can ensure, shall be freed from disruptive influences. On the other hand, adjustability of long contracts for future performances solely dischargeable in money—not including, therefore, those for future delivery of assets against payment of money—should, as far as practicable, be aimed at.

Finally, let us consider briefly the storage function of money. As pointed out above, this is inherently inconsistent with that of measuring; while the units of the measure are being stored they obviously are withdrawn from availability in the task of measuring assets. The use of money as a store of value takes the form of idle bank deposits, or, worse still, of hoarding of currency. In so far as the units of the measure thus stored were previously engaged in the measuring of goods and services, their withdrawal into idleness throws upon the remainder—*ceteris paribus*—the burden of measuring an as yet unchanged volume of goods and services, and unless more frequent changes of hands occur, *e.g.* unless the velocity of turnover of this remaining volume of money units increases correspondingly, the result is that fewer units of the measure seek to be exchanged for goods. Hence these latter will depreciate in terms of the unit of money, more goods will be equivalent to the same number of units of money, the price level of goods tends to fall.

Clearly, if we wish to avoid the depressing effect upon the price level of goods and services occasioned by withdrawal of money units from their measuring function in order to serve as a store of value, we must ensure that the storage of value shall take a form which will not prevent money from continuing to act as a measure of current goods and services. What this implies will be developed in subsequent chapters.

A system under which it is possible to tamper with the measure of value as indicated above is open to grave objection.

When we shall come to examine the disrupting effect of changes in the relationship between money and goods, we will realise the vital importance of ensuring that the measure itself shall no longer be subject to manipulation, whether from banking policy, speculation or any other cause. Nor will we then tolerate any longer the use of that measure as a store of value in any way prejudicial to the welfare of the community. Only money of which the aggregate volume of units engaged in measuring goods and services could no longer be varied, except in response to, synchronised with, and parallel to variations in the volume of current goods and services to be financed through their several normal stages of progress from producer or importer to consumer or exporter, would satisfy the requirements of a true measure of the value of goods. Then, changes inherent in, or arising from, goods and services themselves could, alone, affect the relationship between money and goods. The problem of meeting the chaotic economic conditions of the world to-day, with its corollary of misery and privation, would then be reduced to its proper proportions—a planned and balanced production and interchange of goods—so as to ensure the maximum of concomitance between production and consumption at the highest conceivable level compatible with the productive capacity of the nation.

CHAPTER 3

THE NOTE ISSUE

NOTES in this country are issued by the Bank of England and only against gold. From the 21st of September 1931, when we went " off " gold, onward we have, so far as the note issue is concerned, been living under a transitional régime. The market price of gold, instead of fluctuating around 85s. per oz. fine within narrow limits determined by the fixed price at which the Bank of England was obliged to buy and to sell gold, has ever since been considerably higher and has, for some time past, ranged in the neighbourhood of 140s. per oz. fine. The issue department of the Bank of England, however, are not as yet empowered to issue notes against gold acquired at a rate in excess of the old price of 77s. 9d. per oz. standard (equal to close upon 84s. 10d. per oz. fine), and this has been applied to all purchases made by the Bank throughout the period from 21st September 1931 to date. These purchases up to 9th February 1938 have amounted to about £206 millions. Hence the figures disclosed by the weekly statement of the Bank of England do not afford a true picture. It will, therefore, be necessary to consider the position not only as it appears from the official returns but as it is in reality.

A considerable portion of the note issue is at present shown as not covered by gold but by Government debt, and to an insignificant extent by other securities, *i.e.* bills of exchange. This is the so-called " fiduciary issue ". It is limited by law to £260 millions, at which it stood until 15th December 1936, when it was reduced to £200 millions, its present figure. In the meantime it was raised to £220 millions for a few weeks around Christmas 1937 to meet seasonal requirements. It may be increased beyond £260 millions temporarily for a specified period upon the representation of the Bank of England. Except with

Parliamentary sanction, such increase cannot be renewed beyond two years.

The fiduciary issue arises to the extent of £11 millions from advances made by the Bank of England to the Government at successive stages of its existence, the security being constituted by the resultant Government indebtedness. A further £3 millions was authorised by the Bank Charter Act of 1844. In addition, some few millions are accounted for by the exercise, in years gone by, of the right granted to the Bank of England to increase its fiduciary issue up to two-thirds of the note issue of other banks whose issuing privilege had lapsed.

In the main, however, the fiduciary issue is represented by the incorporation in the note issue of the Bank of England of the Treasury notes colloquially known in their day as " Bradburys ", which owed their existence to the exigencies of the financial situation in the Great War. The security underlying these notes, consisting preponderantly of British Government Debt, was, of course, simultaneously transferred to the Bank of England.

The item " Other Securities " among the assets of the Issue Department originally covered the assets, other than Government securities, held against lapsed note issues of other banks. At present the amount is quite insignificant, but some time prior to the establishment of the Exchange Equalisation Fund in May 1932, it stood at £68 millions. This was, however, quite exceptional and was attributed generally to purchases of foreign exchange by the Bank of England with the object of preventing undue appreciation of sterling. These holdings were subsequently transferred to the Exchange Equalisation Fund.

Whilst the note issue as a whole, as we have seen, is only partially covered by gold, new notes are issued only against gold. This may sound strange to those who imagined that the abandonment of the gold standard involved the divorcement of our money and credit system from gold. What, then, is the significance of our being " off gold " ? It means that ever since 21st September 1931 the Bank of England is no longer under obligation to sell gold,

though it is at liberty to do so. Thus the right to demand that the Bank of England supply gold bars to anyone in command of the necessary purchasing power in the form of currency or a bank balance, was abrogated. Being " off gold " we could no longer be compelled to square deficiencies in our international payment accounts by gold shipments out of the central reservoir at the Bank of England. The implications of this change are far-reaching and will be dealt with at a later stage.

The basis of the currency, however, continues unaltered, with gold as the only asset against which new notes can be issued, and the Bank of England the sole arbiter of such issue. As Bank of England notes, in turn, are the foundation of the whole credit structure, we realise the vital place currency occupies in the financial system.

Whilst the Bank of England is relieved of the obligation to sell gold, it is still technically obliged to buy at the fixed price of 77s. 9d. per oz. standard. With a market price of about £7 per oz. fine, obviously no gold is tendered to it for purchase. Nevertheless, the Bank of England does buy, and, until the existing law is changed, the difference between the amount of notes which, on the basis of the fixed price, can be legally issued against such purchases, and the actual cost of gold, must be supplied from other sources. It is advanced by the Exchange Equalisation Fund, which, in turn, obtains the necessary means by the issue of Treasury bills.

The gold held as cover against the note issue is shown in the statement of the Issue Department of the Bank of England on 9th February 1938 as representing about 62 per cent of the total of notes issued, whereas at the then current market price for gold this percentage would have worked out at about 102 per cent. Thus at present all notes issued are more than fully covered by gold.

Part of the notes issued are held by the Bank of England's Banking Department, there to constitute the reserve against the liabilities of the Bank. We shall deal with this aspect in another chapter, but may mention here that the ratio of this reserve to deposit liabilities of the Bank of England's Banking Department is looked upon as a

barometer of the state of credit. No more misleading index could well be conceived, since both the extent of this reserve, within the limitations of the fiduciary issue, and the aggregate of the liabilities, are subject to the will of the financial authorities. As recently as 15th December 1936 £60 millions of notes which would normally have been added to this banking department reserve, under the existing law, as a result of gold purchases by the Bank of England, were cancelled instead by the device of reducing the fiduciary issue. The additional notes were thus used to repay Government debt held by the Issue Department. The reserve ratio, which would have been raised to close upon 66 per cent, was, in consequence, left at around 32 per cent. I express at this juncture no views on the wisdom of this action, as I am, in this section of the book, concerned with presenting facts, but I merely cite it as an instance of the futility of dangling a completely manipulated percentage in front of the public as having any significance whatsoever except as an indication of the trend of the mind of the money authority.

Having examined the position of the note issue as it is represented to be in the Bank of England returns, we will now analyse the changes which would be revealed if the facts were permitted to be reflected. In doing so we shall be forced to some extent to work on hypotheses, since much of the incidence of the readjustment would depend upon the procedure the Government followed in regard to the uses of the profit which accrues to it on revaluation of the gold. Moreover we are in the dark as to the amount of this profit. We know that the £206 millions added to the gold stock since it touched bottom in November 1931 have, on an average, cost considerably in excess of 85s. per oz. fine, and that the difference has been financed by the Government. Some slight clue may be afforded by an examination of the dates of purchase by the Bank of England, though this still leaves much to guesswork. Since most, if not all, of the gold was in the first place purchased by the Equalisation Fund, it would be the price paid originally by the latter that would determine the volume of Government

debt which has remained outstanding in respect of those purchases after the gold had been acquired by the Bank of England at old standard price. I suggest that by placing the excess cost over standard price at some £85 to £95 millions we shall probably not be very far off the mark.

We calculate the difference between the present book value of £326 millions of gold held by the Issue Department of the Bank of England and its market value at current gold quotations to amount to some £210 millions. If we deduct from this, say, £90 millions as the excess cost over book value of the £206 millions purchased since 21st September 1931, there remains a net profit to be dealt with of £120 millions. How will the Government decide to apply this profit and what course will it follow in regard to repayment of the excess cost financed by Government credit? I believe we may safely assume that the Bank of England, as at present constituted, will use its influence to prevent the adjustment from producing any increase of consequence in the note holding of its banking department and in its reserve ratio to liabilities above referred to. If that is to be a guiding principle, it could be achieved in two ways:

(*a*) By the use of the whole difference of £210 millions in the reduction of Government debt held by the Bank of England, leaving the debt held outside of the Bank of England undisturbed.

(*b*) By the actual transfer to the Government of part of the revalued gold, say to the extent to which it has incurred debt to finance the gold purchased since 21st September 1931, which we have estimated at £90 millions.

To appreciate the effect of the adoption of either course upon the note issue and the Bank of England I submit herewith:

1. Return of the Bank of England as at 9th February 1938.
2. Return of the Bank of England after revaluation of gold on the assumption that course (*a*) is followed.

3. Return of the Bank of England after revaluation of gold on the assumption that course (*b*) is followed.

1. Bank of England Return for the Week ending 9th February 1938, in Millions of £

Issue Department

Notes Issued—			
In circulation .	476	Government debt .	11
In Banking Dept.	50	Other Government securities . .	188
		Other securities . .	1
		Gold . . .	326
	526		526

Banking Department

Capital and reserves	18	Government securities .	93
Public deposits .	16	Other securities—	
Other deposits—		Discounts and advances . 10	
Bankers . 103			
Other a/cs. 36	139	Securities . 19	29
		Notes . . .	50
		Gold and silver coin .	1
	173		173

	Per cent
Proportion of gold in Issue Department to notes issued . .	62 0
Proportion of gold in Issue Department to notes in circulation (notes issued less notes in Banking Department) plus deposit liabilities of the Bank of England's Banking Department .	51·6
Proportion of notes and coin held in Banking Department to deposits	32·9

2. Bank of England Return after Revaluation of Gold at Market Price and Application of Entire Increment to Repayment of Debt held by Bank of England

Millions of £

Issue Department

		Incr. or Decr.			Incr. or Decr.
Notes Issued—			Government debt .	Nil	− 11
In circulation .	476		Other Govt. securities	Nil	− 188
In Banking Dept.	61	+ 11	Other securities .	1	
			Fiduciary issue	1	− 199
			Gold . . .	536	+ 210
	537	+ 11		537	+ 11

Banking Department					
Capital and reserves	18		Government securities .	82	– 11
Public deposits .	16		Other securities—		
Other deposits—			Discounts and advances . 10		
Bankers . 103			Securities . 19	29	
Other a/cs. 36	139		Notes . . .	61	+ 11
			Gold and silver coin .	1	
	173			173	

	Per cent
Proportion of gold in Issue Department to notes issued . .	99·8
Proportion of gold in Issue Department to notes in circulation plus deposit liabilities of Banking Department . . .	84·9
Proportion of notes and coin in Banking Department to deposits .	40·0

3. Bank of England Return after Revaluation of Gold at Market Price and Transfer of £90 millions Gold to Government to reimburse it for Debt incurred in Purchase of Gold. Balance of Profit of £120 millions used for Repayment of Debt held by Bank of England

Millions of £

Issue Department					
		Incr. or Decr.			Incr. or Decr.
Notes Issued—			Government debt .	11	
In circulation .	476		Other Govt. securities .	68	– 120
In Banking Dept.	50		Other securities . .	1	
			Fiduciary issue	80	
			Gold . . .	446	+ 120
	526			526	
Banking Department					
As at 9th February 1938					

	Per cent
Proportion of gold in Issue Department to notes issued . .	84·8
Proportion of gold in Issue Department to notes in circulation plus liabilities of Banking Department . . .	70·7
Proportion of notes and coin in Banking Department to deposits (same as at 9th February 1938)	32·9

Inasmuch as the Government will be called upon to borrow substantially in the course of the next five years

in order to meet the cost of rearmament, gold transferred to the Government under the above hypothesis could, from time to time, be ceded to the Bank of England, to that extent permitting payment of armament expenditure without fresh borrowing. At the same time the holding of notes in the Banking Department of the Bank of England would be strengthened in a period when note circulation and demand for credit are both likely to expand. I append a statement based on the assumption that the circulation has expanded by £10 millions (without increase in the fiduciary issue as shown under hypothetical Bank Return 3), that the credit granted by the Bank of England, reflected in discounts and securities in the Banking Department, has risen by £15 millions, and that the Government retransfers £20 millions of gold out of its holding to the Bank of England.

In Millions of £

Issue Department					
		Incr. or Decr.			Incr. or Decr.
Notes Issued—			Government debt	11	
In circulation	486	+ 10	Other Govt. securities	68	
In Banking Dept.	60	+ 10	Other securities	1	
			Fiduciary issue	80	
			Gold	466	+ 20
	546	+ 20		546	+ 20
Banking Department					
Capital and reserves	18		Government securities	93	
Public deposits	36	+ 20	Other securities—		
Other deposits—			Discounts and		
Bankers 108		+ 5	advances 15		+ 5
Other a/cs. 36	144		Securities 29	44	+ 10
			Notes	60	+ 10
			Gold and silver coin	1	
	198	+ 25		198	+ 25

	Per cent
Proportion of gold in Issue Department to notes issued	86·8
Proportion of gold in Issue Department to notes in circulation plus liabilities of Banking Department	71·7
Proportion of notes and coin in Banking Department to deposits	37·2

Thus the proportion of gold cover against all notes issued, and the gold cover against outstanding notes plus outstanding liabilities combined, have risen somewhat and the cash reserve ratio of the Banking Department is strengthened as compared with the hypothetical position illustrated in Calculation 3.

In the preceding analysis we have premissed that the Government would not apply any part of the increment obtained by revaluation to the redemption of debt held outside of the Bank of England. In view of the necessity for fresh borrowing in the course of the next quinquennium it may be, however, that the Government might first wish to reduce the volume of debt in the hands of the public in order to strengthen the market position and the ability of the banking system to meet demand for borrowing facilities against the new debt to be created. Let us see, therefore, what the position would be if the Government decided to repay debt in the hands of the public to an amount equivalent to the excess cost of the gold previously financed by it. Much would depend upon whether such redemption were effected by gradual reduction of the amount of Treasury bills or by purchase of or invitation to tender long-term securities. The former being held largely by the money market and in turn being to a considerable extent pledged to the banking system as security for loans, their repayment would result in the main in a reduction of the loans at call or short notice from the banks and a simultaneous increase in the balances of the banking system at the Bank of England.

The return of the Bank of England would look as shown in table on p. 25 (using again the figures as at 9th February 1938 as a basis).

As will be seen, this method would greatly strengthen the reserve ratio of the Bank of England's Banking Department and the cash reserves of the banking system represented by their balances at the Bank of England. As indicated above, it is not, therefore, likely to be adopted. The same result, so far as the Bank of England is concerned, would accompany redemption of debt held by others than

Millions of £

		Incr. or Decr.			Incr. or Decr.
Issue Department					
Notes Issued—			Government debt .	11	
In circulation .	476		Other Govt. securities	68	− 120
In Banking Dept.	140	+ 90	Other securities .	1	
			Fiduciary issue	80	
			Gold . . .	536	+ 210
	616	+ 90		616	+ 90
Banking Department					
Capital and reserves	18		Government securities .	93	
Public deposits .	16		Other securities—		
Other deposits—			Discounts and		
Bankers . 193		+ 90	advances . 10		
Other a/cs. 36	229		Securities . 19	29	
			Notes . . .	140	+ 90
			Coin . . .	1	
	263	+ 90		263	+ 90

	Per cent
Proportion of gold in Issue Department to notes issued . .	87·0
Proportion of gold in Issue Department to notes in circulation plus deposit liabilities of Bank of England's Banking Department	74·3
Proportion of notes and coin in Banking Department to deposits .	57·5

members of the money market, but the reserve position of the banking system (the deposit banks) would in that case be reinforced in a slightly lesser degree, if we assume that the long-term debt held outside the money market and repaid was not pledged as security for loans from the banking system. The owners would thus be credited with proceeds which would swell the deposit liabilities of the banks as a counterpart to the increase in reserves; whereas in the case of the Treasury bills that had been pledged, these proceeds would be used to repay loans, involving, therefore, no addition to the banking system's liabilities.

I will ask my readers to bear with me a little longer in order that we may consider yet another hypothetical contingency : the merging of the two departments of the Bank

of England. The balance sheet, after revaluation of the gold and application of the increment to redemption of debt held by the Bank of England, would then present the following aspect (see Balance Sheet No. 2, pp. 21-2):

MILLIONS OF £

Liabilities		Assets	
Capital and reserves	18	Gold . . .	536
Public deposits .	16	Government securities .	82
Other deposits—		Other securities—	
Bankers . 103		Discounts and	
Other a/cs. 36	139	advances . 10	
Notes in circulation	476	Securities . 20	30
		Coin . . .	1
	649		649

Thus gold would represent over 112 per cent of the notes outstanding, and the proportion of gold to all outside liabilities, as we have already seen, would be 84·9 per cent. If, instead, repayment of Government debt held outside the Bank of England were effected, the position of the Bank of England would be weakened in comparison with that shown above; and properly so, since liabilities would be greater without increase in gold holding. This contrasts with the apparent strengthening that would result under the present

MILLIONS OF £

Liabilities			Assets		
		Incr. or Decr.			Incr. or Decr.
Capital and reserves	18		Gold . . .	536	
Public deposits .	16		Government securities .	172	+90
Other deposits—			Other securities—		
Bankers . 193			Discounts and		
Other a/cs. 36	229	+90	advances . 10		
Notes in circulation	476		Securities . 20	30	
			Coin . . .	1	
	739			739	

Proportion of gold cover to notes unchanged.
Proportion of gold cover to all liabilities reduced from 84·9 per cent to 74·3 per cent.

separation of Issue and Banking Departments, as we have seen from the calculation on page 25. The reason is that by the merger the deceptive " reserve ratio " of the Banking Department is eliminated.

It will have emerged from the foregoing survey that under our existing system of presentation of the Bank of England Return, the crux of the entire credit structure lies in the amount of the fiduciary note issue, by the modification of which, at the initiative of the Bank of England, the reserve position of the Bank of England's Banking Department can be manipulated according to its will, with far-reaching consequences to the community, as we shall see in due course. Such power is nowhere vested in any financial authorities, let alone such as are not legally amenable to public control.

In conclusion, I would draw attention to certain other features which stand out in connection with the note issue.

Under our system there is no asset which entitles the owner to actual currency. Even gold is not available to the public or to the banking system for that purpose, but only to the Bank of England, who are enabled but cannot be compelled to buy. The aggregate of the note issue thus rests in the discretion of the Bank of England, though, for the time being, under the special circumstances we have described, the co-operation of the Government is necessary to finance the excess cost over the standard price of gold.

The exclusive prerogative of the central institution in the control of the total of the note issue, and the inadmissibility of any asset, except gold, as a basis for the note issue, are in contrast with practically all foreign systems, even those that have adhered to the gold standard. Invariably, apart from gold, certain other categories of assets give rise to the issue of notes so long as prescribed minimum proportions between gold and note issue are observed at the central institution.

Secondly, since any increase in the note issue is conditioned on the purchase of gold, and gold has to be imported, the balance of international trade is involved

in any expansion of our currency. To the extent that gold must be imported, we either cannot import other goods, or the value of our money—as expressed in terms of other moneys—will be affected in the sense that ours will become worth less. In either case reactions upon the standard of living are entailed.

Finally, it should be pointed out that, under our system, any increase that may be authorised in the fiduciary issue is not tied in any way to specific, approved and eligible assets vital to, or at any rate directly associated with, the economic progress of the nation. It does not follow that such increase in the fiduciary issue, when made, would not in fact originate through developments wholly desirable from the economic point of view, but there are at present no means by which the community can ensure that this shall be the case.

I must content myself for the moment with the bare statement of these features, detached from the numerous other factors that bear upon the working of our money economics. Later, however, when we shall have had the opportunity of reviewing each of the compartments of the structure in succession, it will be possible to weld the piecemeal observations, which we shall be able to extract from this sectional examination, into comprehensive conclusions that will form the working basis for the construction of the new order.

CHAPTER 4

GOLD AND BANK MONEY

IN the previous chapter the connection between gold and the currency has been explained. We will now examine how gold is related to that other form of money, vastly greater in volume—bank deposits. The association is not a direct one. It is currency that forms the link. We shall have frequent occasion to refer to the Bank of England in this chapter, and unless otherwise stated it is the Banking Department which is meant.

When we speak of banks we mean deposit banks; of the banking system, the deposit banks collectively; and of the financial system, the Bank of England together with the deposit banks.

When the Bank of England buys gold, it credits the seller with the purchase price, if he has an account at the Bank of England. If the seller has no account, he is paid by a cheque issued by the Bank of England on itself. That cheque is deposited by the seller for the credit of his account in his own bank. The latter, in turn, deposits it with the Bank of England for the credit of its account. Whether the seller has or has not an account with the Bank of England, therefore, the result will be an increase in the deposit liabilities at the Bank of England. If the seller is a bank or client of a bank this will be reflected in an increase in "Bankers' Deposits", that is, in the deposits of the banking system with the Bank of England; if the seller is a direct client of the Bank of England it will result in an increase in "Other Accounts", that is, the deposits of non-bankers with the Bank of England. In the latter case the funds are nevertheless likely to find their way into "Bankers' Deposits" at the Bank of England, for the owner of the "other account" at the Bank of England will have payments to make out of this account

to others having no account at the Bank of England. In that case the cheques on the Bank of England representing these payments will be disposed of as indicated above and swell the bankers' deposits at the Bank of England. The Bank of England discourages the opening of new accounts. As far as possible it aims at confining its banking functions to those of a bankers' bank.

For all practical purposes, therefore, it would be safe to say that the payment by the Bank of England for gold bought by it results in an increase of its liabilities under the head of "Bankers' Deposits". The corresponding change on the assets side is an increase in the notes held in the Bank of England's Banking Department. It receives these notes from the Issue Department, which creates them upon the gold purchased being lodged with it.

Through the peculiar circumstances to which we drew attention in the previous chapter, the notes received in the Banking Department from the Issue Department cannot be equivalent to the cost price of the gold so long as the Issue Department is not authorised to issue notes in excess of the old standard rate; in other words, so long as gold is not revalued and fixed in terms of the currency. The difference will be reflected in an increase in the "Government Securities" held by the Bank of England, in case the latter advances the difference between official gold price and market price. If, on the other hand, Treasury bills are placed outside the Bank of England to finance the difference, then "Bankers' Deposits" at the Bank of England will not rise by the full market price of the gold, but by the difference between this amount and the sum payable to the Government in respect of the Treasury bills, since this latter sum would be charged to "Bankers' Deposits" at the Bank of England.

Pending revaluation of gold, the acquisition of gold by the Bank of England will thus produce an increment in the note holding (reserve) of the Banking Department less than the market value of the gold. As for the liabilities of the Banking Department, these will either increase in excess of the addition to the note holding, the difference

being offset by an increase in Government securities in the hands of the Bank of England, or they will rise on balance to the same extent as the notes held. For the sake of simplicity we will assume the latter.

Now the notes held in the Banking Department constitute the Bank of England's cash reserve against its liabilities to the outer world. These latter consist in deposits of the Government designated as "Public Deposits", those of "Banks and Bankers", and those of non-banking interests. The two latter categories are jointly classified as "Other Deposits" and separately indicated in the weekly statement as "Bankers" and "Other Accounts". In the aggregate the deposits are only partially covered by notes held. The proportion varies greatly. Since the amalgamation of the Treasury note issue with the Bank of England's own note issue it has fluctuated between 65·8 per cent and 17 per cent. As explained in the previous chapter, however, this proportion is subject to influences closely controlled by the will of the financial authorities. To a much lesser extent is this the case with the ratio between gold held and the combined total of notes in circulation and deposit liabilities of the Bank of England, since the volume of the note circulation cannot normally be directly affected by the initiative of the Bank of England. Special arrangement with the Government might of course be made under which Government departments withdrew part of the credit balances at the Bank of England in notes to be held by the departments, thus raising the total of notes shown as being outstanding in the hands of the public. It would be interesting to know whether part of the hoarding, advanced as an explanation of the exceptional increase in the note circulation during the past few years, is in fact due to hoarding of notes by Government departments in agreement with the Bank of England, so as to diminish the effect which the great influx of gold would otherwise have had upon the reserve position of the Bank of England.

As an indication of the lesser volatility of the ratio of gold to notes in circulation and Bank of England deposit liabilities combined, I may mention that the percentages

at the dates when the above extremes were touched in the Banking Department's reserve ratio were 45 and 24 respectively.

It is clear, of course, that any addition to liabilities, accompanied by an addition to the note reserve representing 100 per cent of the fresh liability, strengthens the reserve position of the Bank of England. Thus an addition to the stock of gold in the Issue Department of the Bank of England improves the reserve ratio (notes held to liabilities) in the Banking Department.

At the same time the reserve position of the banking system, *i.e.* the deposit banks, is improved. The proceeds of the gold—as we have explained—directly or indirectly go to swell the "Bankers' Deposits" at the Bank of England. These "Bankers' Deposits" are part of the reserves of the banking system (the deposit banks) against its own deposit liabilities. Incidentally, we may note that balances at the Bank of England, although regarded as reserves of the banking system to their full extent, in reality only represent cash in the proportion that the notes held by the Bank of England cover the aggregate of the latter's deposit liabilities.

The banking system's deposit liabilities will have increased to the same extent as its balances at the Bank of England as a result of the deposit by the sellers of the proceeds of the gold with the banking system. Thus the purchase of the gold by the Bank of England involves, for the banking system, an increase in the liabilities, fully covered by an increase in that part of the reserves kept in the form of balances at the Bank of England. As the reserves of the banking system, that is, currency and balances at the Bank of England, normally cover liabilities only to the extent of some 10 or 11 per cent, an increase in liabilities which is fully covered by reserves will obviously improve that proportion.

But this is by no means the whole story. On the strength of these additions to the reserves at the Bank of England and in the banking system, fresh credit may be extended to an amount many times that of the gold acquired. When we

speak of the creation or extension of additional credit it is another way of saying that the volume of deposits (bank money) is increased. Let us examine how such additional bank money, based on gold, can be brought into existence.

We shall first consider the Bank of England. Supposing that, prior to the purchase of gold, the notes held represented 40 per cent of the liabilities of the Banking Department. Then, without disturbing this ratio, it would be possible for the Bank of England to allow these liabilities to be increased in all by $2\frac{1}{2}$ times the amount of the new gold purchased. As we have seen, the liabilities (deposits) at the Bank of England automatically increase by an amount equal to the gold bought. How, then, would the Bank of England proceed if it desired to increase its liabilities by a further $1\frac{1}{2}$ times the amount of the gold bought? Just in the same way as you and I would proceed if we had the wish and enjoyed the confidence: by buying something without paying cash for it; by acquiring assets and crediting the seller in our books. There is a further method, however, open to the Bank of England which we could not adopt, namely, lending, by crediting the borrower in its books. That course is available only to banks, provided, of course, there is a demand for accommodation of that kind. A loan from an individual which went no further than a credit in his books would scarcely serve the purposes of the borrower. A credit on the books of a bank would be acceptable, because, by convention, everybody else is willing to accept it.

The Bank of England, therefore, would either purchase assets or offer to lend against them. Its choice of such assets is limited by its charter and by tradition. In practice, only British Government and Corporation securities and bills of exchange are eligible. Purchases of and advances against bills, on the one hand, and securities, on the other, are grouped together under the heading "Other Securities", the total of each of these two subdivisions being separately indicated. Government securities owned and advances to the Government are shown as "Government Securities". The effect of these new purchases and loans upon its

deposit liabilities is the same as that of the purchase of gold. "Bankers' Deposits" will rise, either directly if the assets are acquired from, or the loans made to, the banking system or any of its clients, or indirectly if, in the first place, the seller or borrower is a non-banker having an account at the Bank of England.

When this increase in liabilities—including the addition directly resulting from the purchase of the gold—has reached an amount equal to 2½ times the addition to the note holding representing the new gold, then the former assumed proportion of the note holding to liabilities, namely, 40 per cent, is restored.

How would such action by the Bank of England affect the banking system? As we have just seen, the purchase of assets, or the additional loans made by the Bank of England, will have increased the reserves of the banking system, *i.e.* the Bankers' Deposits at the Bank of England. The banking system's own deposit liabilities will be increased to the same extent, through the deposit, by the sellers and borrowers, of the cheques received by them from the Bank of England.

Instead, therefore, of the increase in its reserves remaining at the original figure representing the amount of the purchase of gold by the Bank of England, the banking system now finds itself, through no initiative of its own, with an increased reserve equivalent to 2½ times the new gold. Assuming that its previous proportion of reserves to deposit liabilities was 10 per cent, then the banking system would now be in a position—in theory at least—to permit an increase in its deposit liabilities equal to a further 9 times the addition to its reserves, without any change in the reserve proportion previously existing. This would work out at a total increase in deposits in the banking system of 25 times the amount of the gold acquired by the Bank of England. However, this is a purely theoretical calculation which has no validity in practice. The reason for this is that part of the reserves of the banking system must be kept in the form of actual currency.

If we assume the proportion between actual cash held

by the banking system and its balances at the Bank of England to be 50:50, it follows that on the basis of a 10 per cent reserve ratio for the banking system any additional liabilities created by the banking system would necessitate an addition of 5 per cent of this increment to the currency holding. This could be achieved only through the withdrawal of part of the banking system's balances at the Bank of England in the form of notes. The note reserve of the Bank of England would accordingly be reduced, and thus the reserve ratio of the Bank of England's Banking Department would deteriorate.

On the basis of a reserve ratio at the Bank of England of 40 per cent, and in the banking system of 10 per cent, of which 5 per cent is kept in balances at the Bank of England and 5 per cent in actual currency, a simple calculation will show that the maximum increase in its deposit liabilities which the banking system could permit, without disturbing pre-existing proportions, would be a little over 14 times the amount of fresh gold acquired at the Bank of England.

So far as the Bank of England itself is concerned, instead of being able to allow its deposit liabilities to increase to the extent of $2\frac{1}{2}$ times the amount of the gold acquired, an increase of just over 0·7 times is all that would be practicable. This means, in fact, that the net increase in deposit liabilities at the Bank of England could not be fully equal even to the total of the gold acquired, assuming that it were understood that the financial system would expand its aggregate liabilities to the fullest extent permitted by the addition to the gold stock, without disturbance to the pre-existing reserve proportions premissed above. If the pre-existing reserve proportion at the Bank of England was 30 per cent, and the banking system's reserve 10 per cent, of which 6 per cent was in actual cash and 4 per cent in balances at the Bank of England, the maximum increase in deposits in the banking system would likewise be about 14 times the amount of the new gold bought, as against a theoretical maximum of about 33, which disregards increased cash requirements.

How would the banking system proceed to increase its deposit liabilities? There are no other means open to the banking system than to the Bank of England for this purpose. It can only buy bills and securities. Lending it can only do in so far as there is a demand for increased accommodation. The range of choice of the banking system in its purchases is perhaps somewhat wider than that of the Bank of England, as the criteria applied by the former are rather less severe. As a result of these purchases the sellers will be credited in their accounts with their banks, and except to the extent that these proceeds are used to repay loans, there will be a rise in deposits, *i.e.* in the volume of bank money.

The foregoing analysis makes no allowance for any additional flow of currency into public circulation. Withdrawals for that purpose would, of course, greatly lessen the possibilities of credit expansion based on fresh acquisitions of gold.

It is within the Bank of England's power to prevent additions to its gold stock from being made the basis of fresh credit. When this power is exercised it produces what is termed the "sterilisation" of gold. If gold is strength in the financial system, then sterilisation of gold strengthens its foundations without enlarging the structure raised upon it. The means employed clearly must aim at the cancellation of the increase in the banking system's balances at the Bank of England occasioned by the gold purchase, so as to deprive the banking system of the basis on which fresh deposits can be reared. This cancellation would be brought about by sale of assets (bills or securities) by the Bank of England. The effect of this sale—so far as the banking system is concerned—would be the exact opposite of that of the purchase of gold. It would reduce the banking system's deposits at the Bank of England, the purchase price being charged to the account of the buyer's bank at the Bank of England. Thus everything would be restored to the position existing prior to the purchase of gold, except that the Bank of England's own reserve position—already improved by the purchase of gold—is

further strengthened by the sale of the bills or securities. Instead of the increased note holding being accompanied by an increase in deposit liabilities at the Bank of England, it is—after the sale of the assets—offset by the reduction in the holding of bills or securities, without any increase in liabilities.

The course just described could, however, be adopted only within relatively narrow limits governed by the extent of the Bank of England's holdings of securities and bills.

Another method of sterilisation is the reduction of the fiduciary note issue. It was applied in December 1936, when against £60 millions added to the gold stock the Government securities in the Issue Department were correspondingly reduced. In that case the gold was already owned indirectly by the Government through the Equalisation Fund. Hence no change was occasioned in the Banking Department of the Bank of England. Of course the quality of the notes outstanding, including those held in the Banking Department, is improved by the substitution of gold for Government securities amongst the assets underlying the note issue, but this is not visibly reflected in the Banking Department's position.

Had it been desired to reduce the fiduciary issue against gold acquired by the Bank of England directly from the importers, this would have involved a deterioration of the reserve ratio in the Banking Department. Proceeds of the gold would have gone to swell "Bankers' deposits" at the Bank of England, whose liabilities would thus have been increased. The notes created against the gold, on the other hand, would not be held by the Banking Department but would be cancelled against transfer of an equivalent of Government securities from the Issue Department to the Banking Department. In the case of the £60 millions above mentioned the proceeds were due to the Government and were used by the latter to reduce its indebtedness to the Issue Department.

Yet another way of achieving the effects of sterilisation would be for notes to be hoarded by Government depart-

ments by agreement with the Bank of England. Notes held in the Banking Department would then be reduced to the same extent as Public Deposits, and to that extent any improvement in the reserve ratio caused by gold purchases would be offset. Obviously, however, this expedient could only be applied on a very restricted scale.

Having considered the repercussions upon the volume of money produced by purchases of gold, all we need say about *sales* is that they have exactly opposite results. There is this vital difference, however : whereas it is possible to sterilise purchases of gold, sales by the Bank of England cannot be neutralised to any appreciable extent.

The proportions which contraction of the volume of deposits in case of gold sales would have to assume to restore pre-existing reserve ratios would be identical with those worked out for the possibilities of expansion when gold is purchased.

It will be realised, therefore, to what stresses the body economic was exposed so long as gold had to be sold in settlement of adverse balances in our international accounts, frequently unrelated to the productive activities of the nation.

In contrast with most foreign banking systems, no obligation rests upon any of the component elements of the British banking organisation to observe any specific proportions between reserves and liabilities. It must be borne in mind, however, that whilst no directly evil effects can accrue from a rising proportion of reserves to liabilities, lack of confidence inevitably results when such proportions are allowed to fall too low. Hence under our present system corrective action is forced upon the banking system in that contingency.

It may be of interest to examine what has actually happened in this country in regard to the gold holding, the note circulation, and the volume of bank money since we went off gold.

[Table

	Millions of £			Per Cent
	Feb. 1932	Feb. 9th, 1938	Increase or Decrease	
1. Gold held in Issue Dept. .	120·8	326·4	+205·6	+170·2
2. Notes held in Banking Dept.	49·4	50·3	+ 0·9	+ 1·8
3. Deposit liabilities of Bank of England	118·3	154·4	+ 36·1	+ 30·5
Of which Bankers . .	70·7	102·9	+ 32·2	+ 45·5
4. Deposit liabilities of banking system	1658·0*	2250·0†	+592·0	+ 35·7
5. Reserve ratio of Bank of England Banking Dept. (ratio of item 2 to item 3) . .	41·7	32·6	..	..

* 10 banks.
† 10 banks, average weekly balances, December 1937.

The above comparison is chiefly interesting in that it demonstrates the extent to which the huge addition to the gold stock has been deprived of influence upon the credit structure. In part this was due to developments outside the control of the Bank of England. Increase in the circulation in the hands of the public and hoarding accounted for about £125 millions, and the banking system holds some £30 millions more notes now than in 1932. On the other hand, £60 millions were deliberately cancelled by the Bank of England, so that there has, so to speak, been no increase in the note holding of the Banking Department. Thus the increase in the credit created by the Bank of England—its deposit liabilities—is accompanied by a drop in the reserve ratio from 41·7 per cent to 32·6. An appearance of strain in the Bank of England has been purely artificially created.

A truly striking picture of the operation of the deflationary tactics followed by the Bank of England is afforded by a comparison given below on the same lines as those followed in the above table but between the average figures for 1934 and 1937. The former was one of active trade recovery; in the latter, a sharp set-back in economic activity became manifest.

[TABLE

	Millions of £			Per Cent
	Average 1934	Average 1937	Increase Decrease	
1. Gold held in Issue Dept. .	191·5	321·4	+129·9	+ 67·8
2. Notes held in Banking Dept.	73·5	45·5	− 28·0	− 38·1
3. Deposit liabilities of Bank of England	155·6	153·9	− 1·7	− 1·1
Of which bankers . .	100·3	97·2	− 3·1	− 3·1
4. Deposit liabilities of banking system	1880·0*	2207·0†	+327·0	+ 17·4
5. Reserve ratio of Bank of England Banking Dept. (ratio of item 2 to item 3) . .	47·2	29·6	..	..

* 10 banks.

† Only figure published is £2287 millions for 11 banks, but £80 millions have been deducted in respect of District Bank so as to obtain comparable figures, that bank not being included in the 1934 average.

The prodigious increase in the gold stock was accompanied by a heavy drop of close upon 40 per cent in the notes held in the Banking Department, in consequence of the cancellation by the Bank of England of £60 millions of notes. In spite of a large increase in the deposits of the Clearing Banks, the Bank of England therefore not only failed to expand the credit base but allowed it to shrink and the reserve ratio to deteriorate heavily.

Had it not been for the fact that the Clearing Banks had increased their own holding of notes by some £15 millions during that period and had permitted their reserve proportion to decrease from 11·3 to 10·3 per cent, the increase in deposits of the Clearing Banks could not have taken place. Well over half of this increase was the outcome of loans granted by the Clearing Banks in response to genuine expanding trade requirements, and during the past year the continued demand for trade loans forced the Clearing Banks to dispose of other assets, mainly bills and securities. Sales of the latter and the general loss of confidence in the stability of money policy resulted in the forcing up of the long-term interest rates by about ½ per cent.

Is it a coincidence that these developments were soon

followed by a sharp reaction in economic activity, in the midst of which we still find ourselves, and from which, it is safe to predict, we shall not emerge until the deflationary tactics above revealed are reversed and our economic life freed from the strait-jacket in which it is imprisoned?

In Chapter 3 we saw how completely our currency is tied to gold. In the current chapter we have endeavoured to demonstrate how, in turn, these notes are the basis on which the whole of our credit structure is reared.

The salient feature which will have emerged from our analysis is the domination exercised over the entire material existence of the community by Bank of England policy in regard to the volume of notes in the Banking Department and the credit it is prepared to build upon that holding.

Chapter 5

THE THREE GRADES OF CURRENCY

The currency, as we have seen, is not static. Its aggregate volume is subject to expansion or contraction through the purchase or sale of gold at the Bank of England. Under normal conditions of progress it should always tend to expand. The currency is held in varying proportions by :

(*a*) The Banking Department of the Bank of England.
(*b*) The banking system (that is, in the main, the Deposit Banks).
(*c*) The public.

The first holding constitutes the reserve of the Bank of England, the second and third combined are the " circulation ", that is, the notes held outside of the Bank of England.

Although legally the units of the currency rank equally in every respect, there is a vast difference in the functions they perform, and in their potency in the credit structure, according to whether they are held in one or the other of these three groups.

The holding in the hands of the public merely passes from hand to hand and serves the current cash requirements of the public. Its potency from the point of view of the creation of credit while engaged in these activities is zero. It, therefore, represents the lowest grade of the three groups.

Currency in the hands of the banking system—whilst held available for the cash needs of the public—performs, while it is in the hands of the banking system, the role of a cash reserve against liabilities many times its volume.

If we assume that normally the total deposit liabilities of the banking system represent some 20 times the amount of actual cash held, it will probably be fair to say that about

half of these liabilities are based on that cash. The reserves of the banking system, as we are aware, include balances at the Bank of England, apart from cash. If they consisted of cash alone, it is probable that the banking system would not be able to permit a greater volume of deposits to come into existence than about 10 times its cash holding. We might, therefore, assign a potency of 10 in the credit structure to the group of currency held in the banking system. It constitutes the intermediate or second grade.

We now come to the holding of the Bank of England. This is not only available for such direct needs of the public as are reflected in withdrawals through the Post Office Savings Bank, and through non-Governmental accounts kept at the Bank of England, but it must be ever ready to be drawn upon by the banking system, which regards its deposits at the Bank of England as part of its reserves.

In addition, it forms the basis of credit within the orbit of the Bank of England itself, ranging in volume, say, from 2½ to 3½ times the amount of this currency holding. A portion of these deposits, as we know, is owned by the banking system. Usually this is well over half of the total, up to about 70 per cent, and itself constitutes part of the banking system's reserves against its deposit liabilities. Thus upon these balances at the Bank of England, owned by the banking system, reposes a volume of deposits with the banking system which it is impossible to compute exactly, as no distinction is possible between deposits based on cash and based on balances at the Bank of England, but which, in round figures, we may place at, say, 10 times the amount of those balances. The foregoing will have demonstrated the high potency of the currency group in the hands of the Bank of England from the credit-creating point of view.

If we wished to assign an index to this group, our calculation would be as follows :

> Proportion of notes held by the Bank of England against all its deposit liabilities, say 33 per cent, making the credit potency within the Bank of England about 3.

Of these deposit liabilities:

> Say 35 per cent represent Public and Other deposits not themselves the basis of further credit.
>
> Say 65 per cent represent Bankers' deposits, which themselves are the basis of credit, say 10 times their volume.

Potency of notes:

In respect of 35 per cent of deposits, non-credit-creating, say about .	3
In respect of 65 per cent of deposits, credit-creating, say 10 times 3 . . .	=30
Average for 100 per cent of deposits, say about	20

The currency holding of the Bank of England, therefore, ranks as the first grade in point of the volume of credit raised upon its foundation.

The size of each of the groups is in inverse ratio to its grade. The Bank of England's holding is the smallest, that of the banking system comes second in volume, and by far the greater part of the whole of the currency—probably at present about 65 per cent—is held by the public at large.

The three holdings are in constant interrelationship, and it is important that we should understand the nature and implications of their reactions on each other.

The public—in which we include Government Departments—has access to the Bank of England's currency holding through the accounts carried directly at the Bank of England, and in addition through the accounts carried by the public with the Post Office Savings Bank, the latter, in turn, having its account with the Bank of England.

The banking system connects with the Bank of England through the accounts which the banks maintain at the Bank of England.

By virtue of the function of the banking system as a depositary for the public, the latter is able to affect the level of the banking system's currency pool.

More important even than the total of the currency from the point of view of the volume of money (currency and bank deposits combined) is its distribution. Whether

an increase in the currency, through acquisition of gold, goes into the hands of the public where it has no potency as a basis of credit, or remains at the Bank of England where it may give rise to the creation of some 14 times its own volume in new deposits, is clearly of great moment to the community.

Over this distribution neither the Bank of England nor the banking system can exercise any direct control. It is determined by the unorganised and cumulative action of the members of the community. To some extent public requirements are foreseeable in so far as they are of a seasonal character. It is also obvious that increased economic activity and higher prices will involve an enlargement of the public's holding.

When this happens, the first effects are the degradation of units of currency of high potency to the menial service of passing from hand to hand amongst the public. Clearly this throws an added burden upon the remaining units in the two higher grade groups.

The only power which controls the source of supply by which fresh additions to the total number of units can be made is the Bank of England. To what grade these units shall be assigned, however, it is not within the competence of the Bank of England to determine. It is predicated upon the requirements of the public in the first place, and the repercussions of these latter upon the banking system.

It will be noted that, at the very periods of greater productive activity, when the creation of additional bank money (deposits) makes it incumbent upon the banking system to increase its currency holding, there is a tendency for currency to be drawn into circulation. Conversely, when the turn of the tide causes a shrinkage of deposits through repayment of loans, reduced cash requirements of the banking system and a reflux of currency from the public holding into the banks coincide. The two high-grade groups when already overloaded with work have to supply reinforcements to the rank and file, and when comparatively idle their ranks are swollen by demobilised units from the great public army.

What are the powers of the system to meet these trends? When the public withdraws currency from the banking system and the savings banks, the cash reserves, both of the Bank of England and of the banking system, are reduced. The banking system can replenish its cash by taking up in the form of currency part of its balances at the Bank of England, but this does not restore the previously existing proportion of total reserves—that is, currency and balances at the Bank of England combined. This proportion cannot be allowed to fall very far, as it is never much in excess of what experience has shown to be indispensable.

The banking system's means of re-establishing the reserve proportion at its former level are in normal circumstances extremely restricted, and none can be effectively applied without the co-operation of the Bank of England. The extent to which such co-operation can be vouchsafed by the Bank of England is in itself severely circumscribed, as withdrawals of currency by the public and by the banking system would have impaired the Bank of England's own reserve proportions.

Ultimately, therefore, persistent needs of currency on the part of the public can be met only by an increase in the total of the note issue through the acquisition of gold by the Bank of England, or an increase in the fiduciary issue. The latter—as we have seen in the chapter dealing with the note issue—is subject to legal restrictions.

Any other remedies—inasmuch as they cannot affect the total of the currency—must aim at the contraction of the liabilities of the banking system and of the Bank of England to an extent sufficient to restore pre-existing proportions. This reduction of liabilities can only be achieved through demanding repayment of loans or through sale of assets by the banking system. Clearly this process cannot be carried far without destructive effect upon the body economic.

Of course, the position at present cannot be termed normal. Although the banking system's reserves represent, as usual, a proportion to liabilities below which they cannot be allowed to fall, the Bank of England has untapped

resources of unprecedented magnitude available for meeting any expansion in currency requirements. The fiduciary issue, to begin with, is £60 millions below the legal limit, and the revaluation of gold would give scope for the issue of a further £200 millions, so that there is no conceivable contingency, short of wholesale withdrawal of foreign balances and flight of capital, with resultant export of gold under the exchange agreements with other countries, which could give rise to the necessity for contraction of the credit structure.

From the above brief analysis of the distribution of the currency, and its significance from the credit-creating point of view according to the grade to which it is assigned, emerges the impotence of the banking system in regard to the contraction or expansion of its holding of currency. None of its assets entitle it, as of right, to the issue of currency by the Bank of England. The latter exercises unfettered discretion in determining the total volume of the currency issued. It combines with this power control over the volume of the remaining part of the banking system's reserves—namely, the balances of the banking system in its books, being able to contract or expand these balances by sale or purchase of securities. Thus the Bank of England in the last analysis imposes upon the banking system the broad lines of policy which the latter needs must follow.

A currency so highly concentrated, so exclusively dependent upon an imported commodity—gold,—so entirely divorced from productive activity, raises grave issues when viewed from the standpoint of its adaptability to the needs of a community in which the full employment of all productive forces shall be the paramount aim.

Chapter 6

THE BANKING SYSTEM AND THE CREATION OF DEPOSITS

In preceding chapters we have briefly examined the position of gold and currency in our money mechanism. Let us now look into that vast and infinitely more significant mass of money represented by bank deposits.

The volume of bank deposits is many times greater than the average amount of currency outstanding in the hands of the public. At present the relation is about 7 to 1. In the turning over of goods, bank deposits account for somewhere in the neighbourhood of 95 per cent of all interchanges. The crucial importance of the banking system to the community is therefore evident.

There is a good deal of confusion concerning the power of the banking system to create deposits. The banking system can and does create deposits. It does so against approved assets, either acquired for its own account or pledged to it as security for loans which it grants. The very act of paying for assets bought (bills of exchange or British Government and kindred securities) in a cheque on itself, constitutes the means whereby the deposit comes into existence. That cheque is deposited by the seller with his own bank, which may be the buying bank or another, and increases the deposits of the banking system. If the seller's bank is identical with the buying bank, this increase in deposits will be offset by an increase in bills or in investments held. If the seller keeps his account in another bank, the latter's increase in deposits will be accompanied by an increase in its balances at the Bank of England, resulting from the buying bank's cheque being credited to the seller's bank through a transfer on the books of the Bank of England. The buying bank will have no change in its liabilities, but a change in the composition of its assets,

securities being substituted for balances at the Bank of England. Thus, taking the banking system as a whole, balances at the Bank of England are unchanged, deposits increase, and bills or investments rise correspondingly.

If, instead of a purchase of assets by the banking system, loans are made, then the credit of the amount of the loan to the account of the borrower represents the new deposit. The corresponding asset is the obligation of the borrower to the bank, recorded by a charge to a loan account, backed, with few exceptions, by collateral security lodged with the bank by the borrower.

We must always keep before us the fundamental truth that, in acquiring assets, or in making loans against them, the banking system pays in a money of its own: bank money or bank deposits. It is solely because the public are prepared to accept this money that the banking system can operate. No individual bank whose "money" was not wanted could keep its doors open. The acceptability of the bank deposit as money is predicated upon confidence in the assets underlying the money created, and in the solidity of the social structure which, in turn, underlies the assets. A bank which bought speculative shares and lent against unsound assets would find that the credit balances it offered in settlement of these transactions would be rejected. It would have no deposits. No valid conclusions concerning the system as a whole, however, could be based on considerations applying to an abnormal case. It is only by regarding the whole of the banking organisation as a unit, and presupposing confidence in it, that we can arrive at a true understanding.

From the fact and process of the creation of money by the banking system, let us pass to an examination of the scope and of the conditions governing the exercise of this power.

When we say that banks create deposits, that statement must be strictly qualified. The total volume of bank money that each bank can safely have outstanding is determined by the amount of cash in hand and balances at the Bank of England, as explained in previous chapters.

Over these the banking system can exercise no independent control.

Moreover, the power of initiative is completely lacking in the very sphere that most vitally influences the material existence of the people—that of loans to enterprise. Failure to recognise this fundamental truth is responsible for the grave misconception which attributes to the banking system unlimited command of credit-creating powers. Even to the uninitiated it must be plain that credit cannot be forced upon unwilling borrowers.

However, the banking system does in a general way possess the prerogative of granting or refusing to grant loans. Even this is subject to qualifications, particularly where important and influential clients are concerned.

In contrast with the completely passive role to which banks are perforce relegated in the expansion of commercial credit, the initiative of contraction does lie with them, though it is not confined to them. It is open to any borrower to repay a loan at any time, even if obtained for a specific period which has not expired at the moment when it is desired to make repayment. On the other hand, in the majority of cases, loans are granted for specific periods, and the bank's initiative of contraction can only be exercised by declining to grant fresh loans or renewals of existing ones when called upon to do so.

In contrast with the passive position the banking system perforce occupies in regard to the creation of deposits resulting from loans made by the banking system, there is a wide field in which the banking system is in a position to take the initiative, both in the creation and contraction of deposits. This covers the deposits created and cancelled as a result of the purchase or sale of assets by the banking system for its own account. However, the effective exercise of this initiative is contingent upon support from, or acquiescence on the part of, the Bank of England. When the banking system buys bills or securities and thereby creates new deposits, the proportion by which its liabilities are covered by reserves deteriorates, for the reserves remain unaffected by the process, as we have

seen above. Since, normally, these reserves are maintained closely to the indispensable minimum, such expansion of deposits could be contemplated by the banking system only in two contingencies :

1. When its reserves are increased.
2. When over a period the amount of loans repaid has exceeded that of new loans granted, and deposit liabilities have thus previously been reduced.

The former is completely outside of the banking system's jurisdiction. The latter is dependent upon the needs of borrowers, which, normally speaking, would not be deliberately discouraged by the banking system in order that it might acquire other assets.

Increase in the reserves of the banking system, as we have seen in earlier chapters, arises from purchases of gold or other assets or from new loans made by the Bank of England. Proceeds being credited to the account of the seller's bank at the Bank of England strengthen the banking system's balances at the Bank of England, whilst simultaneously the deposit liabilities of the banking system increase to the same extent through the crediting of the proceeds to the seller in his own bank. We leave out of consideration any increase in the reserves of the banking system through return of currency from circulation amongst the public, as this is an uncontrollable factor.

Repayment of loans by borrowers in excess of new loans granted would involve cancellation of deposits, accompanied by extinction of the corresponding asset in the books of the bank. Those assets consist in the record of the borrower's obligation to the bank and any security pledged. The banking system's liabilities thus decrease without corresponding decrease in reserve, which strengthens the proportion of the latter to liabilities.

Now it will be noted that there is a great difference between the extent to which acquisition of assets by the banking system without disturbance of the proportion of reserve to liabilities would be rendered possible in the case of an increase in the reserves on the one hand and of a

contraction in the loans on the other. An increase in reserve would permit of a further addition to liabilities by acquisition of assets, say, of 9 times the amount of such increase, without disturbing a pre-existing reserve proportion of, say, 10. The extinction of liabilities through repayment of loans would leave room for replacement by other liabilities only to the extent that liabilities had been extinguished.

It is with bank deposits as with currency. We must distinguish grades. Whilst there are three grades of currency, there are only two of deposits: deposits at the Bank of England and deposits with the banking system. The former—to the extent that they are owned by the banking system—are part of the reserve of the banking system, and may be made the basis of the creation of new deposits by the banking system. To the extent that deposits at the Bank of England are not owned by the banking system (Public Deposits, Other Accounts) they are to all intents and purposes of the same calibre as ordinary bank deposits with the banking system. They are, however, potentially capable of being transferred to the banking system by their owners, and then constitute an addition to the banking system's reserves. So even the non-banking deposits at the Bank of England have a potential quality which the deposits of the banking system lack. This lower grade of deposits have no further credit-creating powers. When returned by the public through repayment of loans, they do not infuse into the banking system the same recreative powers as do the deposits which the Bank of England is in a position to produce.

So much for expansion. What of contraction? Here the banking system is still far more helpless. Normally the initiative of contraction would not be undertaken by the banking system unless this were rendered necessary or expedient. This position would arise in the event of a decrease in reserves, or of the demand for loans by the business community exceeding repayments. In either case it would be necessary to dispose of assets owned, or to reduce such non-trade loans, the prompt repayment of which the banking system would be entitled to demand.

The only class of loans that falls under this definition is the loans at call and short notice to the money market. Both payment for assets sold by the banking system and repayment of such short loans can be effected only out of existing bank deposits. It is unlikely that these would be made available by their owners on any scale for this purpose. The mere fact that a big seller of securities was in the market would deter them, and the necessity for the selling in itself would indicate an increasing demand for the use of bank deposits—in other words, a tendency for interest rates to rise. This prospect would render acquisition of fixed interest-bearing securities unattractive to the public and would cause demand to dry up.

The only source in these circumstances to which the banking system could look is the Bank of England. If the need for strengthening the reserve position of the banking system was the outcome of a drop in the credit created by the Bank of England, it is probable that the Bank of England would itself not be able to intervene as a buyer of securities or as a lender on a sufficient scale. There would remain, therefore, only a purchase of gold by the Bank of England, or an increase in the fiduciary issue. If, on the other hand, the need for sale of assets by the banking system arose from a demand for loans by the business community, and did not originate with the Bank of England itself, there need be no obstacle to the Bank of England extending its aid.

Attention should be drawn to the difference between the volume of sales that would be rendered necessary in either of these contingencies. The loss of reserves would mean a loss of the higher grade of currency or deposits, and would necessitate a contraction of deposits of, say, 9 times the amount of the loss, assuming that the pre-existing reserve ratio to the deposits was 10 per cent. A greater demand for loans by the community—that is, for deposits of the lower grade—would only need the extinction of a corresponding amount of deposits of that same grade, or an increase in the reserves of one-tenth of that amount.

Hedged in though the banking system is on every side by the limitations imposed upon its liberty of action by

elements beyond its control, it will be agreed that—as between the public and itself—the balance of power normally lies with the banking system. This is so by virtue of its authority to determine whether or not a particular loan applied for shall be granted, and further through the initiative vested in it of acquiring or disposing of certain classes of assets for its own account. Moreover, the public are impotent to cancel a deposit once created, except when it comes into the ownership of anyone who has borrowed from the banking system and utilises the deposit to repay a loan.

Most of my readers must at one time or another have seen suggestions offered in the Press as to what banks should do with their deposits. This is like telling a man how to live on his own overdraft. Deposits are a *liability* of the banking system. The only people who can decide what is to be done with deposits, under our present system, are the owners. All the banking system can do is to keep sufficient cash resources to meet likely withdrawals. Once a deposit is created—either automatously by the banking system through acquisition of assets, or in co-operation with borrowers by consenting to loans applied for—then the asset underlying the deposit is determined, and the right to dispose of the deposit is vested in its owner.

Whether the deposit originated from a sale of assets to the banking system, or from a loan by the banking system, it will pass from owner to owner whenever a transaction is done, but so far as the banking system is concerned, the assets underlying these deposits are determined at the time the deposits are created. The asset representing the loan—the borrower's liability—cannot be changed during the time the loan remains outstanding. The assets acquired by the bank outright can be changed, but cannot be disposed of without cancelling a corresponding deposit.

From this brief survey of the conditions under which the banking system expands and contracts the volume of deposits, it will have been realised how essential harmonious co-operation between the Bank of England and the banking system is for the smooth and efficacious working of the financial machinery. As in so many phases of our national

life, absence of fixed legal restrictions and definition of rights has not only proved no hindrance, but an advantage, by leaving latitude for the exercise of initiative and judgment. Yet it cannot be overlooked that circumstances might arise in which the unity of purpose between the control of the Bank of England and of the banking system might be jeopardised. In that case the absence of any legal link between the assets of the banking system and the credit-creating prerogative of the Bank of England might introduce into the position an element fraught with grave consequences for the community.

Chapter 7

HOW BANK DEPOSITS ARE SECURED

The assets underlying the deposits of the banking system are, in part, the property of the banking system, and for the rest they consist of collateral security for loans made and are merely held by the system as pledgees.

The assets owned by the banking system are :

1. Cash (preponderantly currency).
2. Balances at the Bank of England.
3. Bills discounted.
4. Investments.

The assets not owned by the banking system are :

1. Money at call and short notice.
2. Loans and Advances.

It may seem strange at first sight that "Money at call and short notice" is not an asset owned outright. This item, however, would be more truly described as "Loans at call and short notice". With the limitations on the powers of the banking system in expanding or contracting the *aggregate* volume of its assets and liabilities we have dealt in the previous chapter. In regard to the *individual* items, too, the system's scope in that respect is circumscribed. Neither the amount of the cash nor that of the balances at the Bank of England are under its control. The former, within a total issue determined by the Bank of England, depends upon the currency requirements of the public. The balances at the Bank of England cannot exceed such limits as the Bank of England may think fit, and when they tend downward through Government operations or demand for currency on the part of the public, the banking system must look to the co-operation of the Bank of England to restore the balances to a level which,

together with currency held by the banking system, shall be adequate as a reserve against its deposit liabilities. An example of such co-operation was the temporary increase of £20 millions in the fiduciary issue just before Christmas 1937.

As regards "Bills discounted", these include both bills of exchange originating in the interchange of goods, and British Government Treasury bills and kindred paper. The supply of genuine trade bills is limited. Whilst the amount of Treasury bills outstanding is substantial and varies seasonally from other causes, they represent less than 10 per cent of the National Debt and hence offer relatively restricted scope for long-range fluctuation in the amount held by the banking system, when compared with the "Investment" item. This latter comprises medium and long-term securities, and here there is room for considerable changes over a period, as the following figures show:

INVESTMENTS OF THE BANKING SYSTEM
(Millions of £)

Average 1929	February 1937*	Increase	
		Amount	Per Cent
£257	£642 †	£385	150

* High record.

† Aggregate investments as shown in Clearing Banks statement, less investments of District Bank not included in 1929 figures.

The percentage increase of 150 compares with about 32 in the "Bills discounted" for the same period, and 21 if the average for 1937 is taken.

So much for the owned assets.

What of those pledged? The collateral underlying "Money at call and short notice" are, in the main, bills of exchange and short-term securities. The loans included in this group represent the financing of the so-called "money market". Like its companion item amongst the owned assets (bills discounted) and for the same reasons, it is not subject to wide fluctuations. Against the average for 1929, March 1937 shows an increase of a little over 11 per cent.

The possibility of contraction of the items by the banking system depends upon the extent to which the " money market " can find buyers for, or new lenders against, the collateral. By and large, they can look only to the Bank of England in the event of the necessity arising for contraction of such loans on a substantial scale, as there is nowhere a sufficient volume of bank deposits in existence the owners of which would be ready to absorb, or lend against, bills and short-term securities in large amounts.

The largest and, from the economic point of view, most significant individual item amongst the assets is that of " Loans and Advances ". Under it is grouped the accommodation extended to enterprise of every description and to individuals not engaged in enterprise.

The long-term changes in its volume in the course of a period covered by a swing-over of the trade cycle may be of considerable magnitude. The proportion to total assets may range from 30 to over 50 per cent, and what this represents in figures will be gathered from the following example :

London Clearing Banks
(Millions of £)

	Loans and Advances	Total Assets	Proportion of Total Assets
Average 1929 . . .	991	2136	46·4
January 1934 . . .	735	2165	34·0
December 1937 . . .	948*	2486	38·1

* Excluding District Bank, which was not included in previous figures.

Since the lowest point was reached there has been a considerable increase in the absolute total of loans and advances. The proportion to total assets has, however, only risen to a modest extent.

Normally the banking system seeks to maintain as high as possible a volume of liabilities consistent with its reserves. Hence any expansion in the demand for loans, if satisfied by the banking system, will, by causing the deposit liabilities to rise, impose upon the banking system the necessity

to reduce other assets. This is most readily practicable in the assets owned. The upper limit of expansion in the loans may be said to be predicated upon the ability of the banking system, at the cost of progressive depreciation in the value of the assets (securities) sold, to make room for new loans, in so far as the Bank of England does not supply the banking system with additional reserves in proportion to the expansion of the loans and deposits of the banking system. The methods whereby the Bank of England creates such additional reserves for the banking system have been explained in the chapters on the " Note Issue " and on " Gold and Bank Money ".

As regards contraction of loans by the banking system, deliberate pressure with this object in view is likely to be applied at the very period when other causes, including the depreciation of securities referred to above and brought about by bank policy itself, will have provoked a shrinkage in the price level and in the turnover of goods. Clearly, at such a juncture, a policy aiming at contraction of loans must add to the depression and could not be carried far without risk of breakdown of the economic fabric.

Taking the owned assets as a unit and the assets representing indebtedness to the banking system as another, it is clear that their proportion to total assets must vary inversely. Expansion in the latter group, failing an increase in the reserves of the banking system, can be accomplished only at the expense of contraction (sale) of the owned assets, *i.e.* bills and, chiefly, securities. Thus the Bank of England, by withholding indispensable additional reserves from the banking system, is in a position to force up the level of both long- and short-term interest rates.

Another item appears on the balance sheet of the banking system as an asset. It is offset by a corresponding liability, viz. the obligation to the banking system of customers in respect of bills accepted for their account by members of the banking system. This "liability on acceptances" is of a different character from the rest of the liabilities, as no bank money (deposits) is created by the act of a bank

putting its acceptance on a bill of exchange. A deposit is, however, created as soon as the bill is purchased by the banking system from the owner and credited to his account. In so far, then, as acceptances are held by members of the banking system itself we find, looking at the banking system as a unit, that the asset and liability are duplicated in the combined balance sheet of the banking system. The same bill figures both under " Bills Discounted " and under the asset " Liability of Customers for Acceptances and Endorsements, etc.", and as a liability under " Deposits " and under " Acceptances, Endorsements, etc." Assuming, however, that the accepting banks themselves do not hold any of their own acceptances, this double record is inevitable, since the bill which constitutes an asset to the bank which has discounted it is a liability of the bank which has accepted it. At maturity of the bill two assets and two liabilities in the banking system disappear. A deposit is cancelled when the customer's account is charged with the amount of the bill by the bank which accepted it for his account, and simultaneously an asset disappears by the extinction of the corresponding " customer's liability on acceptances ". The actual payment of the bill to the bank holding it causes, so far as the banking system as a whole is concerned, a reduction of the total of " Bills Discounted " amongst the assets and a similar reduction in " Acceptances, Endorsements, etc." amongst the liabilities. Between members of the banking system the payment involves merely a transfer of a balance at the Bank of England from one to another and does not affect the aggregate of the banking system's balances at the Bank of England.

From the point of view of availability to meet withdrawals of depositors—in order words, from the point of view of liquidity—the assets of the banking system may be grouped as follows :

Group I

1. Cash :

2. Balances at the Bank of England :

together constituting the primary reserve.

Group II

1. Loans at call and short notice :
2. Bills of exchange and short-term securities :

together constituting the secondary reserve.

Group III

Investments.

Group IV

Loans and advances.

The degree of liquidity of assets is conditioned upon the Bank of England's willingness to purchase or to lend against them, since the Bank of England is the only ultimate source in a position to supply currency, and currency would have to be available to meet depositors' demands. The first group is immediately available without deliberate intervention by the Bank of England, though—as we have pointed out before—Bank of England balances represent cash only to the extent that notes are held by the Bank of England against its liabilities. Although deposits at the Bank of England are shown to be covered by notes only for a small part, we are of course aware that under present conditions the proportion could be more than doubled by a stroke of the pen, if the legal limit of £260 millions for the fiduciary issue were reinstated. It could be further largely increased by a revaluation of gold, even if the fiduciary issue were simultaneously heavily reduced.

The second group in order of liquidity covers assets eligible for purchase by, or as collateral for loans from, the Bank of England.

The third to a lesser extent fulfils the same criterion.

The assets comprised under "Loans and Advances" rank last in the liquidity scale. They are not the banks' property and they cannot be repledged by the banking system. In any case, under our present system, the security for such loans would in most instances not be acceptable to the Bank of England as collateral for loans.

In connection with the subject of liquidity a word on "frozen assets" may be in place. Frozen assets, from the banking point of view, would be claims on borrowers which

could not be repaid by the latter, either out of the realisation of the collateral security underlying the loans, or otherwise. They are usually spoken of when this state of affairs arises from circumstances inherent in general economic conditions rather than from the financial position of the individual borrowers. In the latter case the asset would be termed a doubtful debt, but would not necessarily belong to the class of frozen assets. Many loans, for instance, to shipping companies and to the heavy industries became frozen assets in the slump of 1930 and the following years through the drying up of the circuit flow of money amongst goods and services, resulting in redundant plant and unsaleable stocks of merchandise. It was universally held that goods were too dear in terms of money, and members of the business community were unwilling to part with deposits in exchange for goods, or procure deposit money by borrowing for the purpose of utilising it in the turning over of goods.

In such circumstances wholesale attempts at liquidation of the security underlying the loans would obviously be futile, and the banking system is doomed to nurse such claims until the security can be thawed out. In so far as causes inherent in money economics are responsible for the disastrous trends that produce these disturbances, it will be our task to trace their nature and incidence.

If it is considered that the assets owned by the banking system—excluding cash reserves in hand and at the Bank of England—plus the assets constituted by the obligation of customers to repay loans and advances, and acceptances, represent about 17 times the combined total of its capital and disclosed reserves, it will be realised how vital to the solvency of the banking system is stability in the value of the assets which underlie its liabilities. Leaving cash reserves, money at call and short notice, and bills discounted out of account, an all-round depreciation of but 7½ per cent in the remaining assets would wipe out an amount equal to the entire capital and disclosed reserves of the banks.

Considering that the average depreciation in the price level of goods at wholesale was about 33 per cent between

1929 and 1932 in this country, the necessity for adequate marginal financial responsibility of borrowers, as well as the importance of strong internal reserves in the banking system, is clearly apparent.

Important though the character of the assets of the banking system undoubtedly is, the use which the owners make of the deposits to which these assets have given rise is of far wider interest. With that aspect we will deal in the following chapter. Meanwhile the striking fact should be borne in mind that no assets directly connected with the current economic activities of the community are eligible for purchase, or as security against loans, by the Bank of England, except bills of exchange, of which the volume serving truly economic ends is insignificant.

Chapter 8

BANK DEPOSITS IN ACTION

We have seen in the preceding chapters how bank deposits are created and what is the security which underlies them. We will now watch deposits at their work.

The ownership of a bank deposit is the indispensable intermediate stage in all transactions involving payment. This applies even to the relatively small volume paid for in currency, since currency must previously have passed through the bank-deposit stage. Before the buyer can complete a purchase, before the earner can pay for his expenditure out of income, before the saver can invest his surplus, a bank deposit must come into play.

The ebb and flow of bank deposits arises only in small measure from the deposit and withdrawal of actual currency. For the rest, bank deposits owe their existence to the initiative of the banking system in purchasing assets (bills and securities) and to the initiative of borrowers in obtaining bank loans against assets. The borrowers' initiative to be effective requires the active co-operation of the banking system. Once deposits have come into existence, however, their disposition, broadly speaking, is outside the jurisdiction of the banking system. It is the owners *pro tem.* of the deposits who determine how they shall be utilised.

Constituting, as they do, the main component element in the volume of money available for the measuring of all assets, deposits are a determining factor in the price structure. In that structure we must distinguish two main groups: existing capital assets and current assets. The former comprise existing securities, existing buildings and land. The current assets include goods and services of every description currently provided. The current goods may be destined either for current consumption or use (consumption goods) or for purposes of construction and fresh

production (capital goods). New securities, the proceeds of which are applied to the acquisition of current goods, are, at their initial sale by the issuing enterprise, assimilable to current goods. Thereafter they become an existing capital asset.

It is the price level of current goods, not of capital assets, that is of primary interest to the average member of the community. There is a definite connection, however, between changes in the price level of the two groups, as we shall see later. It is, therefore, variations of the trends, both in the aggregate volume of the deposits and in the distribution of the activities of deposits as between the two groups, that are significant.

In money economics nothing is static. We are ever concerned with change. Yet, before proceeding to an examination of the nature and effects of these changes, it may be helpful to consider the turning over of deposits, apart from the modifying forces operating upon them. The latter will be analysed in the next chapter.

Legally all deposits rank alike as liabilities of the banking system. An exception should be made, however, in regard to such deposits which represent minimum credit balances, which borrowers are frequently required to maintain with the lending bank, and are usually proportionate to the amount of the loan. The owners *pro tem.* of these balances, *i.e.* the borrowers concerned, are not entitled to dispose of them. They do not, in fact, constitute a liability of the banking system at all, nor does the corresponding indebtedness of the borrower really exist. The total volume of such balances is, however, not important. Apart from these minimum balances, deposits of borrowers with the lending banks are, in certain circumstances, subject to offset against the indebtedness, and would not, in such cases, be enforceable as a liability against the banking system.

The deposits of the banking system stand to the credit either of " deposit accounts " or of " current accounts ". The former comprise the sums which are not utilised by their owners in turning over assets or in paying for services. They are left idle. The bulk of the money represented by

" current accounts ", on the other hand, pass from owner to owner in the course of paying for goods and services and for capital assets. Active deposits are freely convertible into idle ones. When owners of idle money agree not to transfer it to any other owner for a definite period, the money becomes a time deposit. Even time deposits, however, would normally be freed from this restriction on transferability at the request of the owner in consideration of an adjustment of the interest terms. In spite of their ready interchangeability, the distinction between the two classes is a far-reaching one. The whole of the work of settling the infinite mass and variety of transactions that are entailed by the economic intercourse of the members of the community, between each other and with the rest of the world, devolves upon the " current account " deposits. The idle deposits count for nothing in this respect. These latter always represent a large proportion of the total deposits. They seldom fall below 40 per cent and in times of depression reach to as high as 50 per cent.

The volume of payments which active accounts are called upon to perform varies according to the state of trade and the level of prices. An aggregate turnover of current goods and services, new securities and existing capital assets of, say, £90,000 to £100,000 millions in a year would, at current price levels, no doubt be considered as reasonably active. Out of this, some £65,000 millions might be accounted for by payments made by the London clearing banks. If we assume that this work was performed by an average volume of, say, £1200 millions of active deposits during the year, it would indicate that, on an average, these deposits had changed hands between 50 and 55 times. In other words, that their velocity of turnover was 50–55. In a year of depression that figure might be nearer 40. As the total of active deposits is invariably less in bad times than in good, the difference in the aggregate turnover is likely to be even greater than the relative figures of velocity alone would indicate.

Apart from the visible distinction between " active " and " idle " deposits, revealed through their classification as " current accounts " and " deposit accounts " respect-

ively, there is an invisible one arising from the difference in origin of deposits. A volume corresponding to the combined total of the loans made and the trade bills held by the banking system must, so far as the borrowers and the debtors in respect of the bills are concerned, be returned to the banking system at maturity of these loans and bills. This means that borrowers are compelled, before maturity, to have repossessed themselves of a deposit sufficient to repay their loans. In contrast with these " borrowed " deposits, those created through purchase of securities by the banking system cannot be reclaimed by it as of right, and these we may term the " owned " deposits. Of course, all deposits at any given moment are owned by the depositors *pro tem.* So in fact we have to count with three sets of customers of the banking system :

1. Owners of idle deposits (deposit accounts) ;
2. Owners of current accounts ;

who between them own all the deposits at any given moment ; and

3. Borrowers from the banking system, who are owners of assets which they are under obligation sooner or later to turn into a bank deposit to meet their indebtedness to the banking system.

The borrower can be placed in a position to meet his obligations only by transfer to him of an existing or newly created deposit in exchange for his assets. Clearly, if the creation of new deposits did not keep pace with the cancellation of deposits entailed by repayment of loans by borrowers or sales of securities by the banking system, it would become progressively more difficult for borrowers to exchange their assets for the required deposit. To the borrower, owners of idle deposits are useless. He can only look to owners of active deposits, *i.e.* current accounts, existing or potential. The willingness of such owners to acquire, at a suitable price, the assets which the borrower relies upon for repayment of his loan determines his ability to repay.

To draw valid inferences in respect to economic developments from the features of the banking position we shall thus, apart from the total volume of deposits and the relative proportions of idle and active deposits within that total, require to consider the relationship between the active deposits and the loans, and its trend. When the indebtedness in respect of loans (and trade bills) exceeds the volume of current accounts, it is an indication of a strained banking position. *Vice versa*, when there is an ample margin between the amount of the active accounts and the amount of the loans, borrowers should encounter no difficulty in exchanging their assets for a current account deposit for the repayment of their loans.

That there must be a close connection between the state of credit in the banking system and interest rates is obvious. That the credit position produces an inexorable reaction upon the price level of goods, none the less potent because it is not immediate, will be less apparent. The following table throws an interesting light on the subject :

Period	Clearing Banks			Index of Gilt-edged Securities. Averages of End-Month Figures (End Dec. 1923=100‡)	Approx. Long-term Yield of British Govt. Stocks	Board of Trade Index of Wholesale Prices (1931=100)	Bank of England Primary Commodity Index (19th Sept. 1931 =100)
	Millions of £		Ratio of Current Accounts to Loans Per Cent				
	Amount of Current Accounts	Amount of Loans†					
1925	923	856	111·8	100·8	$4\frac{5}{8}$	159·1	..
1926	921	892	103·2	99·6	$4\frac{3}{4}$	148·1	..
1929	940	991	94 8	98·6	$4\frac{7}{8}$	136·5	..
1931	895	919	97·4	95·8	5	104·1	118·4§
1933	978	759	128 8	119·7	$3\frac{3}{8}$	102·4	121·1
1935	1054	769	137·0	126·7	3	106·2	139 9
1936	1197*	865*	138·3	126·3	3	112·8	150·4
Jan. 1937	1254*	880*	142·5	123·3	$3\frac{1}{8}$	122·9	176·9
Feb. 1937	1217*	803*	134·7	120·8	$3\frac{1}{4}$	124·2	177·5
June 1937	1253*	963*	130·1	118·7	$3\frac{7}{16}$	132·2	179 4
Nov. 1937	1238*	986*	125·6	120·4	$3\frac{3}{8}$	129·6	156 4

* 11 banks, elsewhere 10.

† Genuine trade bills discounted had to be ignored, as their amount is not separately indicated by the banks. ‡ *Investors' Chronicle.* § Average of last 14 weeks.

The table demonstrates the close correspondence between the current account–loan ratio and the price level of fixed interest-bearing securities. The trends of the wholesale commodity index are similar but rarely co-

incident in time and intensity with those of the current account–loan ratio. There is a time lag of some years between the two. Wholesale prices of commodities still remained relatively high long after the current account–loan ratio had pointed to increasing strain in the credit position. They fell precipitately when the worst strain had passed and continued sagging while the banking position eased. Likewise the recovery in wholesale commodity prices progressed but slowly at first during a period when the current account–loan tension was rapidly giving place to superabundance of current account money. In time, however, the current account–loan ratio invariably prevails.

A much more sensitive and significant index is provided by the price movements of primary commodities. The Bank of England has published data of those fluctuations from end September 1931 onwards. The concomitance in the trends of this index and those of the current account–loan ratio are very striking.

Deposits in action produce turnover. This is reflected in bank clearings, which, however, by no means cover all changes of hands of deposits. A closer approximation, though still far from complete, is provided by the figures of debits passed to current accounts in the London clearing banks. Statistics of the total turnover of deposits afford a useful index to economic activity, when considered in conjunction with other factors. Mere changes in total, or the absence of them, will not have much significance, for the price level of the assets turned over will, of course, influence the aggregate figure of turnover. Further, it is important that we know something about the nature of the work done by the deposits in their changes of hands. Have existing capital assets, for instance, played a bigger or less important part than goods as compared with previous periods ? Unfortunately on this score we have little precise information. Nor are we much better off in this respect so far as the composition of the turnover in goods is concerned. It would, for instance, be interesting, as a guide to economic trends, if we had an idea of the relative proportions in which primary produce and manufactured

goods figured in the total turnover, as compared with previous periods, and if, amongst the latter, capital goods and consumption goods were distinguished. Some clue to these points may, of course, be gleaned from existing sectional statistics, but the figures of banking turnover would have greater significance if they could be read in conjunction with comprehensive data classifying the assets turned over on some such lines as above indicated. Equal figures of banking turnover may cover widely differing pictures of economic welfare and prospects. Nevertheless it is possible to distil from the figures of turnover valuable premonitory indications when, apart from price level, we take into our purview the relationship between current accounts and loans in the banking system, and the velocity of turnover of deposits. As is the case with every aspect of life, the present reflects the past and, at the same time, reveals the shadow of things to come. How is the prophetic element to be distinguished from the retrospective and from pure actuality? To illustrate this I append a table giving, for each year since 1925, the current account–loan ratio, the

(1) Period	(2) Ratio of Current A/cs. to Loans	(3) Ratio of Current A/cs. to Total Deposits	(4) Clearings, Average of Daily Figures, London Clearing Bankers (Millions of £)*	(5) Index of Clearings (1929 = 100)	(6) Velocity Index (1929 = 100) based on London Clearing Bankers' Figures (column 4) and on Average Current A/cs. of London Clearing Banks	(7) Board of Trade Wholesale Price Index (1913 = 100)	(8) Bank of England Primary Commodity Index (19th Sept. 1931 = 100)
1925	111·8	57·6	137·8	90·9	92·6	159·1	..
1926	103·2	57·3	135·0	89·1	90·9	148·1	..
1927	100·4	56·2	140·9	92·4	93·8	141·6	..
1928	100·7	55·8	149·4	98·6	97·1	140·3	..
1929	94·8	54·1	151·5	100·0	100·0	136·5	..
1930	95·6	52·9	146·3	96·6	98·5	119·5	..
1931	97·4	52·7	121·9	80·5	84·4	104·1	118·4‡
1932	102·7	49·4	108·3	71·5	77·5	101·6	108·9
1933	128·8	51·3	109·1	72·0	69·2	102·4	121·1
1934	126·6	51·8	119·8	79·0	78·0	105·3	135·0
1935	137·0	53·8	126·9	83·8	74·7	106·2	139·9
1936	138·3	54·9	136·4	90·0	73·8†	112·8	150·4
Jan. 1937	142·5	55·5	151·6	100·0	78·1†	122·9	176·9
Feb. 1937	134·7	55·0	156·6	103·4	83·2†	124·2	177·5
June 1937	130·1	55·1	148·9	98·3	76·9†	132·2	179·4
Nov. 1937	125·6	54·7	138·4	91·3	72·3†	129·6	156·4

* London Bankers' Clearing House.

† Computed after deducting £50 millions from figure of current accounts for 11 banks on the assumption that District Bank, whose figures were not included in the active deposits for previous periods, accounted for £50 millions of current accounts, in each case.

‡ Average of last 14 weeks.

ratio of current accounts to total deposits, a clearings and a velocity index. The price level is represented by an index of wholesale prices and, so far as available, of primary commodities.

From each single index only partial conclusions can be drawn as to the current position and none at all concerning the future.

By reading the trends revealed by each in correlation with the movements in others we shall be able to gauge impending developments with a reasonable degree of probability and sometimes with certainty.

A persistently declining trend in the current account–loan ratio of the Clearing Banks, combined with increasing turnover and rising velocity, such as we found, for instance, in the period from 1925 to 1929, points to a growing strain in the credit system. This means that the amount of money which ultimately has to be repaid to the banking system has been constantly expanding in comparison with the volume of money actively employed and available for such repayments. At the same time the increase in the velocity of turnover indicates that the active money is called upon to do ever more work.

If, at such a juncture, there were evidence of a growing proportion of idle money being made available for active turnover and if commodity prices were simultaneously rising, we should be able to conclude that there was need for further expansion of Central Bank credit. If this were not forthcoming, and assuming both current account–loan ratio and velocity were approaching unsafe limits, we should be justified in prognosticating that the rise in economic activity could not endure.

We find in the 1925–1929 period, however, that these symptoms were accompanied by a falling ratio of active money to idle accounts and a declining price level. Both indicate that the exceptional activity shown by the other indices was becoming increasingly uncommercial, and was therefore likely to be of a speculative financial character. Having regard to the declining price level and the increasing credit strain, the prospects of such speculation in such

circumstances could only be regarded with misgivings, and we should be safe in predicting that a break must inexorably follow sooner or later.

Both the index of the current account–loan ratio and that of velocity of circulation have absolute limits which cannot be ignored for long. When the current account–loan ratio falls to the neighbourhood of 100 it is indication of severe credit strain and we should have to watch the policy of the Bank of England very closely for signs of relief.

As regards velocity of turnover, experience has shown that an average daily turnover in the clearings representing an annual amount equivalent to the changing of hands of active deposits fifty times in a year must be regarded as an upper limit. It is presumably equivalent to a real velocity of over 70, having regard to the changes of hands of deposits not reflected in the clearings. It is the velocity which was reached in 1929, when an average of £940 millions of current accounts produced clearings of about £46,500 millions and total turnover estimated at over £66,000 millions.

It must not be taken for granted that the same combination of indices as preceded the collapse of 1929 and following years need necessarily be reproduced before an impending downward swing of the trade cycle can be diagnosed. Many other factors enter into the problem, of which confidence is perhaps the most elusive, since it depends so largely upon international political and economic policies and other imponderables over which no control can be exercised here.

Until the beginning of 1937 all the portents justified the expectation of continued economic activity. The current account–loan ratio had risen to a level which indicated ample ease in the credit position, current accounts constituted a growing proportion of total deposits, clearings were rising, yet velocity left a wide margin for further increase. Perhaps the only feature inspiring some misgivings was the rapid rise in commodities, brought out vividly by the commodity index in Column 8. The financial

authorities here and in the United States did the rest. Rumours were mysteriously circulated of an intended downward revision of the gold price in the United States, and the Bank of England's deflationary tactics forced the banking system to dispose of liquid assets, including securities, to satisfy the growing demand for loans. International politics contributed their share towards the prevailing depression. In a word, confidence was destroyed.

The indices at present faithfully reflect the prevailing uncertainty, falling prices, slackening off in turnover and velocity, and reversal of the trend of the current account–loan ratio since November 1937. There is nothing in the indices, however, which presents any obstacle to a prompt and vigorous resumption of active trade. It must not be forgotten, on the other hand, that a renewal of demand for trade loans can only be met by sales of other assets, mainly securities, by the banking system, unless and until the Bank of England restores confidence in its willingness to expand the credit base in harmony with such rise in the loans of the banking system. Failing this, additional loans by the banking system portend a rise in long-term interest, in itself a factor destructive of confidence. As we have seen, there could be no justification whatever in the gold position of the Bank of England for any such restrictive policy.

Chapter 9

CYCLICAL CHANGES IN DEPOSIT TRENDS

If we can clearly discern the causes, inherent in money economics, of the changing trends in the volume and utilisation of deposits, we shall have taken a long step towards fathoming the enigma of the trade cycle. With the latter we shall deal in the next section of the book.

The changes in deposit trends may be classed under three heads :

1. Changes in aggregate volume of deposits.
2. Changes in composition of deposits (idle and active).
3. Changes in disposition of active deposits (according to whether they are engaged in turning over existing capital assets or current goods).

The banking system controls the changes in the aggregate of deposits within such limits as the Bank of England's power to determine the system's reserves permits. Whilst the banking system cannot be compelled to increase its deposits when its reserves are enlarged by the Bank of England, it has no option but to contract them when these reserves are depleted. In practice the banking system invariably expands its deposits when the basis of its credit structure is broadened, as the maintenance of excess reserves would not be profitable. We are aware from our analysis in earlier chapters that changes in deposits are brought about :

Firstly, at the initiative of the banking system through purchase or sale of securities or through the calling in of loans.

Secondly, in response to the initiative of the business community through the granting of additional loans.

Thirdly, at the initiative of borrowers through repayment of loans.

Changes in composition of deposits or in disposition of the active ones fall outside the jurisdiction of the banking system, being governed by the will of the owners *pro tem.* of the deposits. Yet that will is in a large measure, though unconsciously, shaped by forces engendered as a result of banking policy in respect to the aggregate volume of deposits.

The banking system is impotent directly to influence the price of goods, because it does not deal for its own account in goods or documents representing goods. It can and does, however, influence the price of existing securities by purchase or sale. When such operations form part of a deliberate and sustained policy, their inevitable corollary is to change the price relationship between existing securities and current goods. We shall endeavour to trace the effect of this change upon the psychological outlook of the business community, reflected in turn in cyclical changes of trend in the utilisation of deposits, with far-reaching repercussions upon the entire price structure.

Let us assume that, at the moment we begin our observations, we find that the proportion of idle to total deposits is unusually high—say 50 per cent, instead of 45 per cent or thereabouts as would be more normal. This seemingly unimportant difference might mean that some £100 millions more of deposits were idle, instead of turning over 60 to 70 times in a year in payment of £6000 to £7000 millions of business. The remaining active deposits, we will suppose, are turning over at declining velocity. We will further assume that loans, though not at a high level absolutely, still bear a high proportion to active deposits—say around 100 per cent, instead of 70 to 80 per cent—indicating scarcity of active deposit money. Owned assets (investments) of the banking system are small in comparison to loans—say 40 per cent, compared with 75 to 80 per cent at other times.

The hypothetical position we have chosen as our starting point we would associate with low and declining prices for goods, high interest rates and trade depression. Also we should expect to find the price level of fixed interest-bearing securities low, owing to prevailing high interest rates, and

equities (shares) falling because of actual and prospective poor results.

At such a juncture the banking system, acting in co-operation with the Bank of England, begins to " prime the pump " by policy. It begins to acquire securities—that is, existing capital assets. The new bank money thus created circulates in the first place amongst owners of capital assets. It changes the value of existing capital assets in relation to current goods, causing the former to appreciate in terms of goods.

What changes, as compared with the starting position, will this monetary policy, after it has had time to permeate the structure, have wrought in the significant proportions in the banking system?

1. The total of deposits will have increased.
2. The proportion of active deposits to total deposits will have increased, as the bulk of the new bank money will remain on active account, being utilised in turning over securities.
3. The proportion of loans to active deposits will have declined. Loans will not have risen—in fact, may have decreased—as the creation of new bank money will have made repayment easier, and as yet no inducement exists for fresh borrowing. The remaining loans will have become more liquid. There is more money out of which loans may potentially be repaid.
4. The proportion of owned assets (investments) to loans has risen, with its corollary of a rise in price of existing securities. This is tantamount to a fall in the level of interest rates.
5. Although no data are available showing the proportion of active deposits working in securities and in current goods, the former is likely to be relatively high.

These changes of fact produce psychological reactions on the mind and outlook of the business community. The drop in the level of interest rates, brought about by this bank policy, will gradually have its favourable effect upon profits through opportunities for conversion of long-term debt and

lower charges for current borrowing. Better results will stimulate spending and encourage enterprise, with resultant increase in demand for goods and expectation of rising profits.

Some of the deposits engaged in turning over securities will be diverted by their owners to the turning over of goods, swelling the body of deposits already working in that field. The initiative in the measuring process will have passed to the owners of money. Money will be offered more freely in exchange for goods. The relationship of goods to the volume of money engaged in measuring them will have changed, in the sense that there will be more of the latter without—so far—any corresponding increase in the quantity of goods. In fact, the conditions we have assumed to prevail at the beginning would have tended to restriction in output of goods, which it would not in every case be practicable to reverse promptly. Thus the price of current goods goes up. Meanwhile owners of deposits, at work in turning over fixed interest-bearing securities, have become aware of the better prospects ahead for industry and other forms of enterprise, and will have diverted their deposits to the acquisition of shares. The consequent appreciation of share prices will facilitate the issue of new capital by existing or newly created enterprise, the proceeds of which will be utilised in payment for current goods. Expectations of continuance in the upward course of the price level of goods will determine enterprises to carry out expansion and renewals now rather than later.

Gradually we reach a stage where the added volume of goods changing hands renders the carrying of larger stocks expedient. Up to a point the more active turnover of existing deposits will obviate the necessity of an increase in total deposits through loans, but there is a limit to the velocity with which deposits can turn over owing to the time factor. There is always a volume of deposits amongst the current accounts that is temporarily idle, even at the highest pitch of activity. Thus the need for additional loans will gradually make itself felt. Now, however, the banking system, having built up on its reserves the maximum structure of deposits

which they can safely sustain, can only grant additional loans by selling a corresponding amount of its own assets. I am assuming that the Central Bank, at this juncture, takes no steps to increase the reserves of the banking system. The banking system thus is obliged to recapture deposits from some owners in order to place them at the disposal of others: the borrowers. It can, however, not force those owners to exchange their deposits for securities, and sales could be effected only gradually.

The kind of deposits which the banking system in this way is likely to attract, cancel and re-lend would be such as are employed in turning over securities, or possibly some that were previously idle. The new deposits created in their stead, as a result of the new loans granted by the banking system, will be working in goods. So, although there is no change in total deposits, and possibly only a minor one in the relationship between idle and active ones, the disposition of the active deposits is being modified. An ever-growing proportion is utilised in turning over current goods, and a correspondingly smaller one in existing capital assets. It will be of interest again to examine the relevant features of the banking position:

1. The total of deposits has remained stationary.
2. The composition of deposits has remained stationary, with a tendency for the proportion of idle deposits to decrease.
3. The proportion of loans to active deposits is rising.
4. The proportion of owned assets (existing securities) to loans is falling, with depressing effect upon the price level of fixed interest-bearing securities in the first place.
5. The disposition of active deposits has changed in the direction of a larger proportion being engaged in turning over of current goods and a smaller in existing securities. Although, as I said before, there are no statistical data to substantiate this, the fact that a larger proportion of the active accounts emanates from loans by the banking system and a

lesser one from purchases of securities justifies this conclusion. It is borne out by the behaviour of the price level during a period such as here described, as demonstrated in the table in Chapter 8.

We have arrived at a point in the cyclical trend when again we should take stock of the psychological factors. We know that there can be no further increase of aggregate deposits. We know that, if the demand for loans continues, the offer of securities for sale by the banking system must continue. What way will the situation develop ? I designedly leave out of consideration any development not germane to financial policy.

In contrast with the position at the earlier stage, when all the facts irresistibly pointed in one direction, there is now room for divergence of view. There will be many who, engrossed in the affairs of the moment and impressed with the greater activity in business, will look upon future prospects with confidence and will continue to enter into commitments relative to the production and distribution of goods. There will be others who will grasp the significance of the monetary forces that are at work. They will realise that in the preceding period considerable additions have been made to plant, increasing substantially the output of goods. Business never for any length of time remains stationary. The urge to increase turnover and profits will always operate. Thus they are fully aware that turnover may grow still bigger and that output may be still further enlarged. As the existing active deposits will, by this time, have attained their fullest velocity, this means that further loans will be required, and these can be granted only if securities are sold. That involves a drop in the price of fixed interest-bearing securities, *i.e.* a rise in the level of interest rates, which spells, in turn, higher costs and reduced profits. Those, then, who reason in this fashion will begin to take in sail. Their future engagements will be gradually reduced ; their current turnover is not forced up any higher, and if in this way they have, in time, no need for part of their deposits, they will transfer them to idle account. For a time

the hopeful outlook prevails, being more congenial to the majority of people. Loans continue to expand. Fixed interest-bearing securities continue to fall, and this is bound to affect the price of shares in time, even though, at this juncture, expectations of still better results of enterprise may keep in check the effect of inevitable adjustment of share prices to the higher long-term interest rate. What is happening is that new loans obtained from the banking system in order to finance increased production—which ought to render existing capital assets more valuable, since more profitable—are in fact causing a depreciation in the market price of such capital assets, as represented by securities. This is due to the fact that the banking system is obliged to sell securities in order to grant the loans. A conflict is thus set up in this sphere also.

Gradually, however, the two currents of opinion—the more confident and the more critical—begin to be more evenly distributed, with the effect that repayment of loans and the demand for new loans balance each other out. There is not, however, any immediate reaction upon the production of goods. The productive capacity has been constantly added to, right up to this time, and it will take a while before the engines can be switched over into reverse. Thus the volume of goods continues to increase, not from causes inherent in goods, but as a result of developments that had their origin in money policy and the human urge for expansion. The relationship between the volume of active deposits engaged in turning over goods and the volume of goods is changing. The price level of current goods is beginning to decline. The period of equilibrium between opposing trends is ended. The signs again are unmistakable, the conclusions irresistible. The banking position now presents the following picture:

1. The total of deposits still stationary.
2. The composition of deposits altered. Idle deposits increasing.
3. The proportion of loans to active deposits still rising, but now not necessarily because of increasing

loans but because of transfers from current account to deposit account.

4. The proportion of owned assets (securities) to loans at low ebb. Prices of fixed interest-bearing securities declining.
5. In the disposition of the active accounts the proportion turning over existing capital assets has fallen to a low level.

Now there are no two opinions as to the likely course of the price of goods. Those previously hopeful and deeply committed are forced to sell and cut their loss, adding further to the depression. To pay for losses in goods, securities have to be sold, causing the fall in existing capital assets to be accentuated. To absorb these sales a shrinking volume of active accounts alone is available. The banking system does not increase its loans; on the contrary, it presses for repayment of existing ones. Neither does it as yet purchase securities; the outlook is too uncertain. Idle accounts are not likely to be tempted out of their retirement to engage in purchase of goods or securities. Even the reduced volume of active deposits turns over at a slower pace. The economic position of the community rapidly deteriorates. Profits decline. Unemployment rises and we are fast approaching a state analogous to that which we premissed at the start:

1. Aggregate of deposits down through repayment of loans.
2. Composition further deteriorated by high proportion of idle accounts.
3. Proportion of loans to active accounts now easing through repayments.
4. Proportion of owned assets (securities) to loans at low ebb.
5. Disposition of active deposits presents marked feature of change. The proportion turning over securities is probably lower now than at any time.

The following table will illustrate the process of cyclical changes in deposit trends:

Economic Trend	Period	Proportion of Deposits of Bank of England to Deposits of Clearing Banks. Per cent	Difference against preceding Year. Per cent	Clearing Banks.** Millions of £			Proportion of Loans to Current Accounts	Proportion of Current A/cs. to Total Deposits	Proportion of Loans to Investments	Security Prices† 31st Dec. 1923=100		Wholesale Prices‡	
				Loans	Current A/cs.	Investments				Gilt-Edged	All Securities	1913 =100	1923 =100
Up	1923	7·74	..	761	1001	357	76·1	59·8	213·2	100§	100§	158·9	100·0
	1926	7 68	− 0·8	892	921	265	96·9	57·3	337·0	99·6	119 6	148·1	93·2
Down	1929	6·57	−14·5	991	940	257	105·4	54·1	385 6	98·6	Jan. 134·2 Dec. 105·6	136·5	85·9
Up	1932	7·54*	+14·8	844	867	348	97·3	49·4	242·5	109·4	78·6	101 6	63·9
	1936	6·95	− 7·8	865	1197	643	72·3	54·9	134·5	126·3	130·0	112 8	71·0
	Feb. 1937	6·75	− 2·9	903	1217	671	74·1	55·0	134·6	120·8	137·0	124·2	78·1
	June 1937	7 04	− 4·3	963	1253	654	76·9	55·1	147·3	118·7	129·8	132·1	83·1
Conflicting	Nov. 1937	6·90	− 2 0	986	1238	634	79·6	54·7	155·5	120·4	118·7	129 6	81·5

* For 1933 and 1934 the proportions rose to 8 26 and 8·46 respectively.
** 10 banks until 1936; 11 banks from 1936 onwards.

§ 31st December 1923.

† *Investors' Chronicle.*
‡ Board of Trade.

As will be seen, 1929 is the culminating year of a period of ascending activity and, at the same time, the beginning of the greatest depression of modern times. There are certain features surrounding that crisis, however, which at first glance appear enigmatic and irreconcilable.

The rapidly rising security index between 1923 and the beginning of 1929 is scarcely compatible with the growing indications of credit strain revealed by the banking figures nor with the crumbling commodity prices during the period. It is also interesting to note the relatively insignificant drop in gilt-edged securities, in spite of substantial sales, on balance, by the banking system. It is also surprising to find that declining commodity prices were accompanied for a number of years by a large expansion in loans of the Clearing Banks. This might not be inconsistent for a relatively brief period, since it is conceivable that business could expand on a gently declining price level for a while. Persistence of the discrepancy, however, points to non-commercial use of the proceeds of the loans and this would explain the seemingly incongruous big rise in security prices. For this upward movement there was no justification in economic facts or prospects at the time and it constituted the relatively mild reflection of the speculative orgy that had taken possession of the United States. The figures in the above table may serve as an illustration of the persistence of maladjustments which, but for the lack of control by the banking system over speculative utilisation of bank money, could not have reached such magnitude nor lasted so long. Instead, the indiscriminating and ruthless method of general deflation was mercilessly applied by the Bank of England, as strikingly revealed in the proportion of Bank of England deposits to the structure reared upon them, *i.e.* bank deposits. This proportion was forced down from an average of 7·74 per cent in 1923 to 6·57 per cent in 1929, a drop of no less than 15·1 per cent.

What followed is still fresh in our memory.

After the catastrophe of 1929 the Bank of England reversed its policy and during 1933 and 1934 the average

proportions of Bank of England deposits to Clearing Bank deposits were 8·26 and 8·46 respectively. The latter figure represented an advance of nearly 29 per cent upon the low ebb of 1929. Since then, however, while economic activity was making rapid headway, the Bank of England has again put the screws on: witness the declining ratio of the credit base to the credit structure. It was in November 1937 only 5 per cent above the 1929 low ebb. Is it any wonder that this deflationary trend, coming on top of all the other uncertainties business has to contend with, is having a disorganising effect upon enterprise?

Are we then headed in the same direction as in 1929? We certainly appear to have entered upon a stage in the cyclical trend in which the policy of the Bank of England assumes cardinal importance. Failing an increase in its reserves, the banking system has had to have resource to the sale of assets to satisfy the demands for increased loans. Thus cash, bills discounted and call loans in November 1937 were, in the aggregate, some £69 millions below the December 1936 figure, and investments were £26 millions less. On the other hand, advances to customers were over £100 millions higher. It is not surprising in these circumstances to find that the long-term interest rate has risen, as reflected in a drop in gilt-edged securities and a larger one in "all securities".

There is, however, this vital difference between the position in 1929 and now. Loans at that time constituted 55·1 per cent deposits, whilst the average for 1937 was 41·7 per cent. This is strikingly reflected in the loan-investment index. Thus, even if the Bank of England were to continue to fail to provide an ampler credit base, there is now a substantial margin for an increase in loans from the point of view of the liquidity of the banking system. Whereas 55 per cent must be regarded as more or less an upper limit, the 1937 figure was still abnormally low. The security index too is well below the figure for January 1929, indicating that adverse features have been substantially discounted.

It must not be overlooked, however, that now, as at

any time, loans can only be expanded by the Clearing Banks at the expense of other assets unless the Bank of England enlarges the credit base, *i.e.* unless the significant proportion (see Column 3 of the above table) shows a rise. Otherwise any revival of trade must be accompanied by sales of securities by the Clearing Banks, which means the forcing up of the long-term interest rate. The nefarious consequences of such a development have been described in this chapter. Incidentally, too, in view of the borrowing requirements of the Government for armament expediture, it would throw an added burden on the taxpayer for which there can be no justification of any kind in the position of the Bank of England.

It would be deplorable if, after the terrible lessons of the past, failure to provide adequate reserves for expanding legitimate trade should ultimately again result in plunging the country into depression. There could be no justification for such a policy, having regard to the inward strength of the banking position as revealed in the calculations submitted in Chapter 3. The crude remedy of forcing up the long-term rate of interest should be discarded once and for all.

We have, in the foregoing analysis, endeavoured to follow the changes in the behaviour of deposits from a period of depression through recovery to activity and relapse into depression. The answer to the question why trade depression should supervene at all, with its train of misery and demoralisation, must be left for investigation in the next section. We know that, so long as the corrective is sought in bank policy, they must inexorably result. The causes, however, lie far deeper in the composite disrupting forces engendered by the defects of the financial system, the dealings of man with his money and the lack of comprehensive planning in the economic sphere.

For the moment I would draw attention to the features revealed by our study of the utilisation of deposits :

1. Expansion and contraction of deposits in pursuance of bank policy bears no relation to the process of production and interchange of goods, being effected

solely through acquisition or sale of existing securities by the banking system.

2. The banking system does not exercise any effective control over the disposition of the deposits created through its instrumentality. It clearly cannot do so at all in so far as such deposits result from purchases of securities by the banking system itself, and it does so in quite inadequate measure in so far as deposits are concerned resulting from loans granted by it.
3. No concerted scheme for dealing with speculation in all its phases has been devised, so that the lending capacity of the banking system, which under our present system is circumscribed by Bank of England policy, is exposed to abuse with attendant penalisation of the entire body economic.

CHAPTER 10

FINANCIAL REFORM AND ITS SCOPE

IN this concluding chapter of our sketch of the inner working of the financial system we propose to take stock of the position.

Not until we have examined the impact of the money mechanism and the community upon one another—which will be the objective of the Second Section of the book—can we expect to arrive at conclusions and discern the lines upon which reform must be conceived.

Meanwhile what progress has been made in finding the answer to the seemingly unfathomable problem we set out to probe : the problem of finding the missing link between God's overflowing bounties and man's unsatisfied needs ?

All grave disturbances of the body economic are associated with changes in the relationship between money and goods ; in other words, with changes in the price of goods. Any solution must aim at isolation and sterilisation of the factors responsible for these crises. Let us not imagine, however, that when this is done, our task is completed. Even at the peak of so-called prosperity periods hundreds of thousands of our fellow-members of the community are without work, and hundreds of millions throughout the world permanently live in squalor and misery. Stability indeed we seek, but stability not at any level of activity hitherto attained, but at one that shall allow for the fullest use of all the resources of energy and productive power available within the community and shall be capable of indefinite upward adjustment as those forces expand. Utopia ? We shall see. Clearly, however, the solution of our problem must reach far beyond reform of the financial mechanism and must embrace the regeneration of wide areas of our entire social order.

For the moment, however, we must confine ourselves

to the financial organisation. That it is capable indirectly of affecting the price level of goods will have emerged, in a general way, from the foregoing chapters. It may be useful here to point to the specific features which, actually or potentially, operate in that sense. They belong to the realm of law, custom and policy, the three forces that dominate the functioning of the system. The law links the entire credit system to gold and determines the assets against which the Bank of England may extend credit. Custom allows certain forms of utilisation of the banking system, disruptive of the relationship between money and goods, *i.e.* speculative financing and idle deposits, whilst policy involves action at the initiative of the banking system the far-reaching effects of which upon price level have been described in the preceding chapter.

We shall be better in a position to appreciate the significance of these features when our survey of the mechanism of the financial system shall have been supplemented by a study of the ways in which man deals with his money. Meanwhile it may be helpful briefly to indicate the directions in which they are capable of exercising repercussions upon the price level of goods.

A normally expanding economic structure based, as is ours, upon gold, requires a correspondingly growing gold holding at the Central Institution, in order that increased credit requirements for legitimate trade purposes may be met by the banking system. Gold on the other hand is the only available means of settling balances in international payments accounts. Inasmuch as no conscious effort to maintain equilibrium in those accounts is practicable in an unplanned State, the two functions of gold may, and often do, conflict. When we attempt to conceive of gold solely as the basis of credit, divorced from other factors, we realise that over long periods the normal growth of productive economic activities necessitates additions to the gold stock at the Central Bank. This in itself involves, for a non-gold-producing country, importation of gold from abroad. Theoretically, to the extent that we had to pay for gold we could not pay for other goods from abroad, so that the

imported gold would displace other imports which could have been afforded if gold had not been needed as a basis for credit. As gold, under our system, is equivalent to money, the volume of money upon acquisition of gold by the Central Bank is increased without any direct corresponding increase in the volume of other goods, a stimulating factor so far as the price level of goods is concerned. In practice, as there would be no deliberate abstention from other imports to make room for gold, the bill for such temporary stimulus as would be provided by the addition to the gold stock at the Central Bank would have to be footed when the exchange began to reflect our excess imports. Under a gold standard this would then entail deliberate contraction of credit and high interest rates, and under a managed currency depreciation of the value of the pound in terms of foreign currencies, with attendant rise in the cost of all imports. In turn, reactions upon other goods and so upon the standard of living would be produced. I can here do no more than hint at the ramifications of the linking of our credit structure to gold. When dealing with the international aspects of our money economics I hope to revert to the subject.

As regards the limitations upon the nature of the assets against which the Bank of England extends credit, goods, or documents representing them, are barred save for bills of exchange. Only a very minor proportion of the interchange of goods and services is financed by means of these latter. Whilst this restriction does not of itself constitute an element of disturbance in the price level of goods, credit being obtainable against goods from the banking system, it may nevertheless operate in that sense. Since no right is vouchsafed to the banking system automatically to fall back upon the Central Bank when demand for commercial loans increases beyond the capacity of the banking system to satisfy it, the banking system, failing assistance from the Central Bank in other ways, in such circumstances would be obliged to sell assets (securities), with depreciating effect upon their market price. The indirect influence of persistent sales of that kind by the banking system on a large scale upon the whole economic fabric we have traced in the

preceding chapter dealing with cyclical changes in deposit trends.

We now come to the effect of disruptive features which, in fact, constitute conscious or deliberate abuse of the mechanism of the financial system, but which have become ingrained by "custom's idiot sway". Facilities are customarily afforded by the banking system to solvent borrowers, against approved security, for the purpose of enabling the latter to acquire existing securities or other existing capital assets or commodities, even though such purchases are speculative ones. This involves disturbance in the price level of the assets so acquired, not inherent in causes related to the production or distribution of goods. If commodities are the object of such speculation, the influence on the price of the goods concerned is direct, which is bound to produce distortion in the price relationship between those and other categories of goods.

If existing capital assets are involved in such speculation, the effect upon the price level of goods will be indirect, but as we have seen from the sequel to the speculative excesses of 1929 and the period immediately preceding it, none the less destructive for that.

To the extent that loans of this type are in existence, the banking system's lending capacity is clogged and expansion of credit demand for productive purposes may impose upon the banking system the necessity of contracting its own assets by sale of securities, entailing the forcing up of the long-term interest rate.

Furthermore, the banking system, whilst it is not, under our present order, in a position to prevent money from being kept idle by its owners, offers an inducement to depositors for not utilising their money, by higher interest allowances on deposit accounts, thus encouraging the use of bank money as a capital investment. When the volume of idle money increases or declines, as revealed in a rise or drop in the aggregate of "deposit" accounts, without a corresponding change in the total bank money, this involves depletion of, or an addition to, the volume of money (included in current accounts) actively employed in the turning over

of goods or other assets. Changes in price level are thus entailed.

Finally we come to the question of bank policy. Securities—that is, existing capital assets—are enthroned in our financial mechanism as practically the sole medium, apart from gold, whereby money is created and cancelled. They are by far the chief means which the Bank of England uses for the expansion or contraction of the credit it creates. As we are aware, this credit in turn forms the reserves of the banking system. Genuine trade bills are available only in limited volume, and the bulk of Treasury bills, renewed as they are from quarter to quarter, must, for all practical purposes, be assimilated to long-term securities. The banking system, for its part, likewise expands and contracts its own deposits through the instrumentality of securities. To represent the banking system's purchases of securities as an investment of deposits—as is frequently done in commentaries on the banking position—is contrary to reality. I shall have more to say on this subject later. For the moment, suffice it to note that the total volume of bank money (deposits) is determined in a large measure by the holdings of securities at the Central Bank and in the banking system. We have seen the interaction on the whole course of economic activity of cyclical changes in deposits as a result of transactions in securities by the banking system. The long-term changes in the price level of goods indirectly resulting therefrom are thus attributable to the policy of the banking system.

I refrain at this stage from comment or criticism. The object of our observations was to establish that there are factors inherent in our money mechanism which are capable of affecting the price level.

It will be argued that, in spite of any shortcomings, our financial system is far and away superior to any in the world. Alone of all others it has weathered a devastating world crisis without loss of solvency or earning power. We need have no hesitancy in endorsing this view, but let us not be lulled into complacency by comparison with others and smugly sit back in self-congratulation at our

wonderful good fortune in possessing such soundly managed banks and such a sound people. The consolation we may derive from our undoubted pre-eminence in the conduct of our financial affairs is scarcely likely to satisfy the millions of victims of recurrent trade depressions, whose numbers grow at every fresh swing of the cycle. Let us not be reassured by temporary upward trends. Revivals can have no permanence. As night follows day, every recovery under our present system is inexorably followed by relapse. We have seen how the fostering effect of banking policy facilitates emergence from the deadlock of stagnation at the bottom of depression. But policy cannot avert depression itself, and no study of the financial mechanism alone will reveal its causes. Let us, therefore, press on with the search, so that we may perceive the remedy. "Back to barter", say those who are exasperated by the failure of authorities to find a solution. Tired of palliatives, disgusted with patchwork, they would eliminate the intermediate stage of the money machine between producer and consumer. That would be comparable to the smashing of a looking-glass which, having first been besmudged by its owner, reflected features of which he did not approve. Let us first clear the mirror so that it can reflect accurately; let us see that our money shall not, of itself, be able to distort the relationship between money and goods, nor be subject to influences that do. Then, when the glass is clear, if we do not like the picture it throws back, let us find out what is wrong with the looker.

We must not imagine that reform of the financial system alone could provide the cure for the sad plight in which the human race finds itself in an economic sense. No banking system, however perfect, could avail against the evils of unbalanced production, characteristic of our society, in which economic activity is in the main unplanned. No control over banking policy, however comprehensive, could, alone, safeguard the community against the withering blasts of depression.

Only a co-ordinated complex of reforms, covering not merely the money mechanism, but reaching into every

phase of the economic order where it conflicts with the true interests of the community, could forge the "missing link" and cope with those mighty and obscure forces which hitherto have frustrated every effort at bridging the chasm between productive capacity and the need of consumers.

These forces are deeply rooted in the spirit of man and securely entrenched in the conventional conceptions concerning the rights of the individual in dealing with what he regards as his exclusive possessions, through the instrumentality of the financial system. It is to that aspect that we will now turn.

SECTION II

WHERE THE MONEY GOES

"Ne'er let your gear owergang (master) ye."
(*Scottish proverb*)

CHAPTER II

TWO KINDS OF MONEY

MAN comes into contact with the money system in every one of his multifarious economic activities. All transactions are ultimately paid for by a transfer of money. The overwhelming proportion of such transfers is effected in the form of bank deposits through the instrumentality of the banking organisation.

Infinitely varied is the nature of the individual operations which give rise to these changes of ownership of money. Yet they may all be classified under the following five groups :

1. Payment for work done by individuals (salaries, wages, fees and other types of emolument).
2. Payment for current goods acquired (consumption goods and current capital goods).
3. Payment for services supplied by enterprise, ownership and Government.
   Payment to enterprise includes such items as transport, power, light, insurance, etc.
   Payment to ownership : rent, interest (bank and long-term loan), royalties.
   Payment to Government : taxes, rates.
4. Distribution of profit (in the case of joint-stock enterprise, in the form of dividends).
5. Payment for investment in capital assets (securities, existing or newly issued ; mortgages ; buildings, existing or currently constructed, and land ; transfers to savings banks, etc.).

The first three groups of payments, which I would term " primary ", are disbursements entailed by the normal processes of production and distribution of goods and services. The last two are " secondary ", in that they

constitute a subsequent stage in the turnover of the money disseminated in the primary group.

Not all money that changes hands in the course of these payments owes its origin to, or is utilised in connection with, *current* economic activity. As indicated in the title of this chapter, we must distinguish two kinds of active money. They exist side by side and outwardly are indistinguishable. They are convertible into one another and are utilised indiscriminately. Yet in their nature they are essentially different. It is our failure to discriminate clearly between them that obscures our vision of the part played by money in the disruption of the interchange of goods and the resultant periodical trade depressions.

I shall designate these two types of money as " commodity money " and " financial money ".

Commodity Money is created when the banking system grants loans the proceeds of which are distributed in connection with the normal economic activities of the community. All existing bank deposits, engaged in turning over goods of every description or services connected with the normal economic life of the community, likewise function as commodity money. Money paid for new securities the proceeds of which are expended by the enterprise concerned in current goods—whether these goods be of a capital nature or consumption goods—may be assimilated to commodity money. Loans granted by the banking system for speculation in commodities function as commodity money, but it is different in its effect upon the body economic from normal commodity money and we must distinguish it as " speculative commodity money ".

Financial Money, on the other hand, may arise from bank policy, *i.e.* from purchases of securities by the financial system. At its creation it serves to absorb existing capital assets. How it is subsequently used depends upon the decision of its owners. The use which owners of deposits make of their money determines its character at each change of hands. When money is applied to the acquisition of existing capital assets (securities, buildings, land) it functions as financial money. The recipient of a salary is

receiving commodity money. He will probably use the bulk of it in paying for goods and services and to this extent it continues, in its passage from him to the suppliers of the goods and services, to serve as commodity money. A portion of the salary may, however, be devoted to the purchase of some existing investment; that portion of the money, in that particular change of hands, would then have been converted into "financial money". Finally, the proceeds of loans from the banking system, utilised by the borrowers for the speculative acquisition of existing capital investments, are, in their first turnover, to be assimilated to financial money. The borrowers are, however, obliged to repay the loan at some time, and, as explained in an earlier chapter, are potential sellers of assets against money. The existence of this speculative financial money is an ultimate source of weakness in the price structure.

No reliable clue is afforded by the position of the banking system as to the proportions in which the two types of money, "commodity" and "financial" money, are, at any given moment, represented in the turnover of active accounts. We are aware that there is constant diversion of commodity money to financial uses through the process of investment of surplus income in existing capital assets. At the same time, the reverse process, the transformation of financial money into commodity money, may go on to a certain extent—for instance, through utilisation of proceeds of existing securities sold to the banking system, in the purchase of goods or of new securities when issued. How
ever, this is in evidence on a substantial scale only un
certain conditions that provide a stimulus in that sens

It is important for the diagnosing of the eco
position that we should be able to determine whic
two currents is, for the time being, supreme or wh
are in equilibrium. At times this ascendancy
the other is well defined, and, as we shall se
system's power to create and cancel mo
influence in their interplay.

Whilst exact estimates are impract
a comparison of certain relevant

system at different periods permits of inferences concerning changes in volume and direction of the two currents that may have supervened in the interval.

As an illustration we submit the following figures, most of which were included in the tables given in Chapters 8 and 9, and which relate to a period during which marked change in the composition of active bank deposits, as between financial and commodity money, took place. The grounds for this conclusion and its significance are explained below :

Period	Clearing Banks					Velocity Index of Current Accounts (1929 = 100)	Index † of Security Prices (all Securities) (31st Dec. 1923 = 100)	Index § of Wholesale Prices (1913=100)
	Millions of £		Ratio of Current Accounts to Total of Current Deposit and Other Accounts	Millions of £				
	Total* of Current Deposit and Other Accounts	Total of Current Accounts		Investments	Loans			
1926	1665	921	57·3	265	892	90·9	119·6	148·1
1929	1800	940	54·1	257	991	100·0	121·6	136·5
							‡Jan. 134·2	
							‡Dec. 105·6	
	+135	+19	..	−8	+99	..	..	..

* Includes £56 millions of other accounts in 1926 and £62 millions in 1929.
† *Investors' Chronicle.* ‡ End. § Board of Trade.

The total of current accounts increased but slightly. Yet the total deposits rose by £135 millions. As we find that loans were about £100 millions higher (call loans, not shown here, also rose), involving the creation of an equivalent
mount of additional deposits, it is clear that this credit
pansion, originating with the borrowing public, was not
t by contraction of the banking system's own assets.
s confirmed by the figures of the investment holdings,
how only an insignificant movement.
king feature that emerges from the above com-
at the " idle " accounts rose to an extent nearly
ntire increase in deposits (from 43·7 to 45·9
enlarged total). Now, obviously, the new
a result of the additional loans would
he borrowers, though in subsequent
might, of course, have been with-

drawn from activity. In any case there is incongruity in extensive fresh borrowing and simultaneous heavy increase in idle money. The increase in the velocity of turnover index of deposits also seems scarcely consistent with a persistently sagging price level. The faster changing of hands of deposits would normally, like the expansion of loans, be associated with growing economic activity, whilst both the rise in idle money and the definite downward trend of commodity prices pointed in the opposite direction. The clue to the significance of these conflicting movements was supplied by the securities index, which by January 1929 had reached its peak at 134·2, thus revealing the uses to which the new borrowings were being put. An increasing volume of active money was evidently functioning as financial money in the speculative turning over of securities, while the volume of commodity money was both absolutely and relatively declining through transfer to " idle " account by owners who preferred, in the perplexity of the situation, to abstain from commitments.

However, it is one thing to interpret symptoms and quite another to understand why the transactions which produced them were ever entered into. Justification for them certainly appears to be absolutely lacking. To push up the market value of assets, the yield on which, by all indications, is bound to fall, and this at a time when the credit structure showed unmistakable signs of severe strain, is intelligible only in the light of the speculative mania rampant at that time.

Normally speaking, we should expect to find an increase of bank credit for speculative non-commercial purposes coincide with a period when the banking system had increased the total volume of money by bank policy, *i.e.* by purchase of securities.

It is at the depth of depression, when there is scarcity of financial money and when commodity money is not wanted, that the banking system begins to exercise its prerogative of creating new financial money by purchases of securities in the market. The volume of commodity money in operation at such a time would be at a low ebb. Loans are

being repaid in so far as the assets which formed their basis are realisable at all; turnover is small; profits are dwindling; producers and Governments under pressure of economic necessity are attempting, individually or in combination, to restrict output. The creation of this new financial money, by its very nature, raises the price of existing securities, which is equivalent to saying that it reduces the level of interest rates.

When we witness a consistent increase in the volume of financial "policy" money, it is only a question of time, given confidence, when the conversion of some of this financial money into commodity money sets in. This transformation is brought about through reduction of fixed and current charges resulting from declining interest rates. Profits are thus stimulated, and this will induce some of the money engaged in financial pursuits to interest itself again in the turning over of goods. Moreover, the financial money created by the banking system will be passing from hand to hand in the acquisition of other securities, not only fixed interest-bearing ones, but also shares, in view of improved prospects. As securities rise and are sold, some of the proceeds will constitute profits, and it is probable that at least part of these profits will be spent on goods and services of divers kinds. Thus a portion of that financial money ceases to circulate in turning over capital assets and is diverted into acquisition of goods. Two influences then, the reduction of interest charges and the spending of profits made on securities, will cause financial money to be diverted to commodity uses. This will operate to alter the relationship between goods and commodity money, and even without the intervention of any factors solely appertaining to goods (restriction of output, crop failures, etc.) there would be an increase in the money value of goods. The better profits being made and the lower cost of borrowing will now stimulate the creation of fresh commodity money in the shape of banking loans for the purpose of construction of fresh capital assets. Part of the money will be found through the issue of new securities, which will be paid for out of existing financial money and out

of current profits, thus converting financial money into commodity money and preventing the current profits representing commodity money from being turned into financial money by drifting into existing investments. Thus we find a strong flow, fed by several sources, of financial money towards commodity money, and simultaneously a tendency for the reverse current to be stemmed.

An initiative of buying of goods will have been set in motion. It is important in price formation where the initiative lies—whether with buyer or seller. If with the buyer, the volume of money tendered first changes before the volume of assets offered for sale changes; hence more money to an unchanged volume of assets and higher prices for assets. If the seller takes the initiative, the volume of assets offered increases before the volume of money; hence a decline in the price of the assets.

It is at this stage, when already an increasing volume of financial money is turned into commodity money, that more money is likely to be created for speculative purposes, to be utilised both in the acquisition of goods and of capital assets. It will tend to accentuate for the time being the rise of securities and goods, and thus add a deceptive stimulus to the construction of fresh capital assets and to the production of consumption goods. I have ignored the creation of new commodity money in the form of self-liquidating bank loans for the normal processes of production and distribution, as such loans must be regarded as a response to a stimulus already imparted—a symptom rather than a cause.

To the creation of speculative money comes the use of idle financial money—previously held on deposit—in the active turnover of goods. Thus we see financial policy money, financial speculative money and financial idle money all tending to function as commodity money, as well as direct additions to commodity money by an increase in finance—bank loans for construction of new capital assets.

At this juncture the combined influence of these powerful factors easily outweighs the reverse flow away from commodity money which is a constant feature of money

economics. That efflux results from investment of current surplus income in existing assets. This surplus income represents part of the commodity money which changes hands in the normal economic processes of the community, and, by investment of the type referred to, it is diverted from commodity uses. We need, however, only reckon with this flow of commodity money into financial channels in so far as it exceeds the sale of existing investments with a view to employment of the proceeds in the acquisition of current goods.

Why cannot the preponderance of the trend toward commodity money, which, we see, has resulted from the creation of financial money on a large scale by the banking system, continue indefinitely with increasing prosperity and rising or stable prices, until the limit of the community's productive capacity is reached. Why cannot the spectre of the inexorable relapse be for ever exorcised? Certainly there is nothing in the psychological make-up of man that would prevent it. His urge to achieve material gain is insatiable. The answer to our question will be found in the interaction of the two types of money, commodity and financial.

We must remember that there is a limit, purely discretionary, it is true, but none the less real, to the combined total which can be supported by a given volume of cash owned by the Banking Department of the Bank of England. When that limit is considered to have been reached, and when the cash basis is not further enlarged by gold purchases on the part of the Central Bank, then any additional amount of commodity money needed to finance a growing volume of turnover in goods will have to be taken from the existing quantity of money. In other words, demand for further increase in the commodity loans of the banking system can be met only through recapture by it of existing money, by means of sale of securities it holds. The money so cancelled can then be reissued as commodity money in the form of new bank loans. Thus the point is reached where the banking system becomes an active seller of securities and the bulk of the money it thus reattracts into its coffers will be

existing financial money. It may be recalled that the volume of this financial money has, by this time, been heavily depleted through transformation into commodity money as described above. Thus, an insistent demand is concentrated on the reduced volume of financial money in order that the need for more commodity money may be satisfied. Moreover, the total of capital assets has meanwhile been heavily increased through fresh construction, and thus the volume of assets that may be offered in exchange for financial money has moved in inverse ratio to the available financial money.

It needs no imagination to realise that a drop in the value of existing capital assets ensues, the more severe as it is not merely the transfer of initiative to the seller that is involved, but a marked alteration in the relationship between available financial money and financial assets. Security prices decline sharply. The normal flow of surplus income into financial pursuits is not adequate to stem the tide. Thus, at a time when goods are being produced and interchanged in growing volume and ever larger amounts of commodity money are required, it is becoming increasingly difficult for the banking system to attract financial money for the absorption of the securities it has to offer, in order that these proceeds may be converted into commodity money. The growing scarcity of financial money has increased its cost and that of all money. The level of interest rates has risen. Current borrowing charges accordingly are heavier and prospects are that profits will be adversely affected. Whilst the market value of existing capital assets is fast declining, the cost of constructing new ones is high owing to the price level of goods not having been affected in a downward direction so far. Moreover, the annual interest payable, or to be allowed for, on this high cost is likewise heavy.

This discrepancy between the declining value of existing capital assets and the high cost of new ones imposes a check upon the construction of new capital goods. Thus the output of consumption goods, which through inertia and failure to read the signs of the times still continues

unchanged, will meet a reduced volume of commodity money available for its absorption, for the circulation of commodity money changing hands will have declined as a result of the shrinkage in capital goods construction. Apart from this, there is the normal flow of commodity money into investment, now no longer outweighed by a flow of financial money into goods. A deficiency promptly arises in the volume of commodity money available to absorb current goods. Borrowers repay commodity and other loans to the banking system in preference to continuing to utilise the money in turning over goods, which can be sold only at a loss, if at all. In the case of goods, as of capital assets, the initiative has now shifted to the seller.

The total volume of money, financial and commodity, is steadily diminishing through repayment of loans. New financial money is not at this stage infused into the body economic by the banking system. Even it if were, there is no warrant for thinking that it would find its way into goods. Until it was recognised that the supply of goods in the world had been brought into closer harmony with the reduced volume of commodity money, or unless the infusion of financial money were universal, an isolated rise in prices produced by banking policy could, under our present system, only retard revival, since it would provoke imports and discourage exports, vitiating international payment accounts and thus paralysing still further the vital sources of national economic activity. Only when, independently of the financial aspect, adjustment between the volume of commodity money and goods had been tackled from the goods side, would the infusion of fresh financial money be likely to prove effective.

I do not, of course, suggest in the least that we should acquiesce in this state of affairs. The whole object of this book is to point the way towards emergence from the vicious circle which the existing economic and financial system imposes upon us. The suggestion of remedies must be deferred, however, until both the mechanics and human impacts of the structure under which we live have been examined in their various aspects.

In this chapter I have laid stress upon the distinction between two types of money. It will help us to understand much that may appear puzzling in the working of money economics. In particular, it will enable us to form a true picture of the circuit flow of money which we deal with in the succeeding chapter.

Chapter 12

THE MYTH OF THE CIRCUIT FLOW OF MONEY

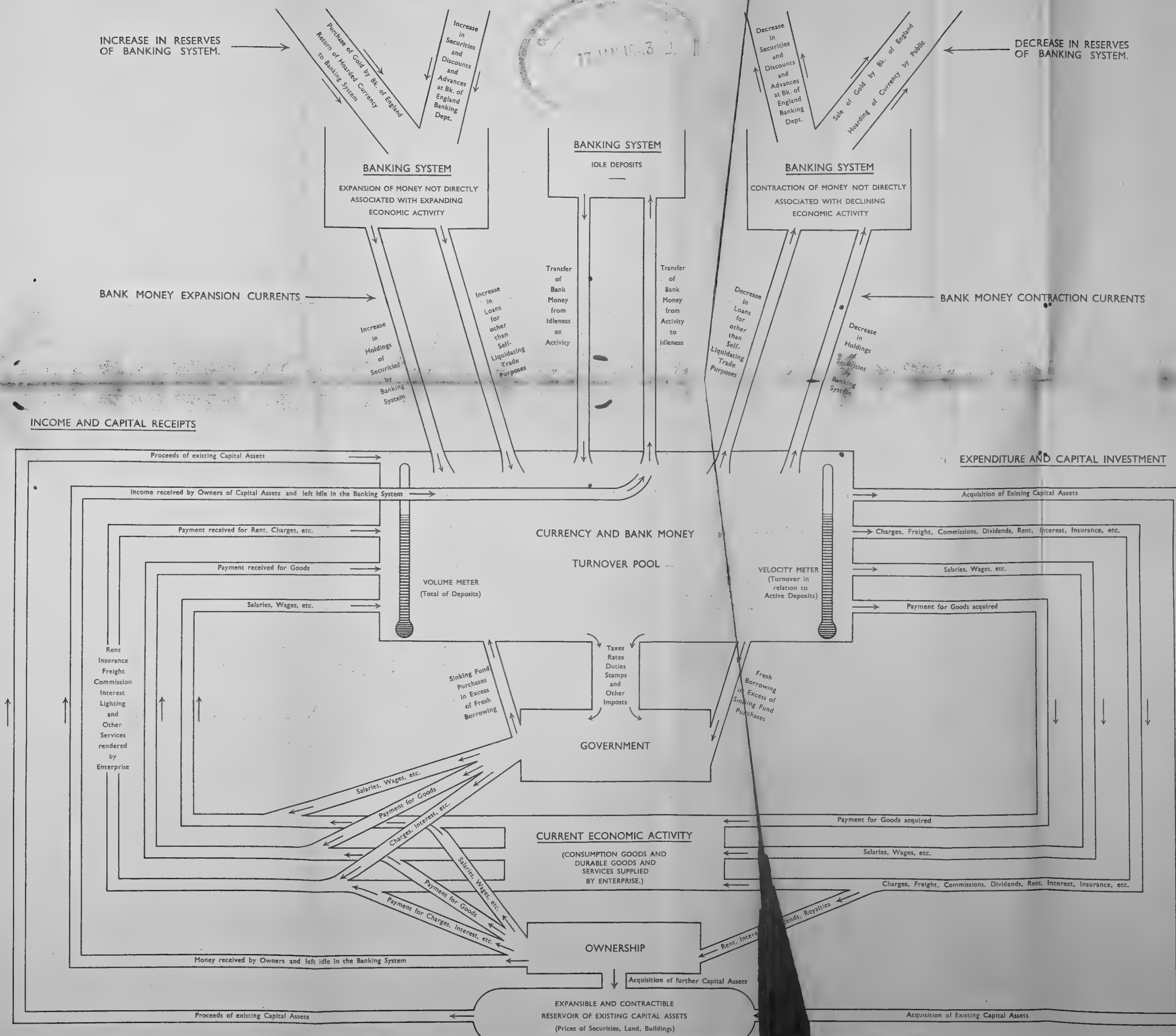
If the flow of money were a perfect circuit, as it is invariably represented to be in text-books on Economics, how is it that, at times, it threatens all but to dry up? Even when its waters are in spate, in times of so-called boom, they fail to fertilise large tracts that thirst for their life-giving properties. A considerable part of the productive forces of the country remains permanently unutilised. Yet the natural urge of man is towards the highest possible level of material welfare. To this end he will strain every effort. If, then, he fails in this object, it is safe to conclude that he has found the obstacles insuperable.

In fact, the individual, even if he possessed the necessary technical equipment to unravel the problem, would be totally impotent to do aught to alter the state of affairs with which he is confronted. Its root causes lie concealed in the intricacies of the entire texture of the financial and economic organisation, and they may be summarised as follows:

1. Defects inherent in the technical constitution and policies of the financial system.
2. The disposition made of surplus income.
3. The failure to plan economic activity in all its phases, domestic and international.

Only the united will of a majority of the community bent upon ensuring for every one of its members the highest measure of material well-being, and individually willing, in order to achieve this goal, to make sacrifices in the interest of their fellow-beings, could prevail against ignorance, callousness, thoughtlessness, greed and—last but not least—inertia, which conspire to perpetuate the inequalities of opportunity, the appalling waste of human energy and of

CIRCUIT FLOW OF MONEY UNDER EXISTING ORDER



moral qualities, now so distressing a feature of our economic structure.

Before we can deal specifically with the principal features of man's contacts with money economics under our present order, it is necessary to have an insight into the flow of money.

I commend to my readers a careful perusal of the accompanying chart, which graphically illustrates the principal characteristics of the flow. With the aid of the comments which follow, it should afford a useful guide through the labyrinth of the turnover of money in settlement of the boundless variety and infinite succession of transactions that constitute human economic intercourse.

Viewed casually, that interchange appears a vast jumble which defies any attempt at disentanglement. If, however, we can, for an instant, banish the consciousness of bewildering simultaneity and visualise the process as if all analogous functions were synchronised and then moved forward in proper sequence, the impression of chaotic confusion in the flow of money will give way to a sense of orderly co-ordination.

We shall take the money currents emanating from "economic activity" as our starting point on the chart, and we shall assume that any increase in bank money required to finance expanding economic activity is automatically forthcoming in the form of genuine self-liquidating trade loans from the banking system, whilst declining economic activity is similarly reflected in contraction of bank money by repayment of such loans. On the other hand, we shall, just for the moment, ignore any expansion or contraction of the volume of money passing through the turnover pool in so far as this is the outcome of bank policy, the reactions of which upon the flow of money amongst goods and services will be explained later in this chapter, after we have surveyed the normal flow.

For the sake of simplicity we shall distinguish three zones in the flow of money, as if they were consecutive instead of coincident.

In the first round we include the money disseminated

in connection with the production and distribution of goods and services by enterprise of every description, *i.e.* down to and including the retail distributor. The second will cover the spending of that part of the stream which has become the income of the individual in the preceding economic process; and the third will trace the course of a further part which has assumed the form of profit of enterprise.

As we have seen in the preceding chapter, the money distributed in the first zone is directed by the power-house of economic activity into three channels:

1. Payment for goods of every description needed in the process of production and distribution.
2. Wages, salaries and other payments for work done by individuals.
3. Payment for services rendered by—
   (*a*) Enterprise;
   (*b*) Ownership;
   (*c*) Government.

The payments for goods constitute gross revenue to the recipients, *i.e.* producers, manufacturers, wholesale distributors; payments for work done are the gross income of the individual *qua* active participant in the economic processes; the payments for the services of enterprise are to be assimilated to the payments for goods and represent gross revenue of transport undertakings, banks, insurance companies, suppliers of light and heat, etc.; payments to owners for the right of using their property (houses, money, mineral rights) take the form of rent, interest, royalties and are the gross income of individuals or enterprise *qua* owners. From the point of view of the money flow the payments in this latter group are to be assimilated to payments constituting income *qua* worker. Finally, the payments for the services of Government take the form of taxation in its various modes and become the revenue of the Exchequer and local government authorities.

In so far as all these payments, made by enterprise, are again redistributed into the same channels, the circuit

flow is perfect. We are concerned, however, with the elements of disruption in the circulation of money and we shall find these present when we trace the payments through the second and third zone.

The flow in the second zone represents the re-spending of income of the individual whether received by him *qua* active worker in the economic sphere or *qua* owner. There is a further category of individual income, in every respect resembling the foregoing, *i.e.* income received as owner-enterpriser (sole owner, partner or shareholder in enterprise), but we may leave this for consideration in connection with the money flow in the third zone dealing with the profit of enterprise.

In the main, individual income is redirected through the same three channels above described, though it reaches different sections. Payments for goods will go to the retailer, whilst amongst payments for work done the remuneration of personal and professional services will play a much bigger part. A portion of individual income, however, is not re-spent on goods and services at all, but will flow into a fourth channel leading to investment in capital assets.

In so far as this investment takes the form of payment for new securities, the proceeds of which are promptly re-spent on current goods and services of one kind or another, or for new houses acquired from the constructors, no hitch in the flow of money arises. On the other hand, if this surplus income is utilised in the acquisition of existing securities, land or buildings, it is diverted from the flow of money circulating amongst goods and services. That diversion may be more than a purely passing phase, according to the destination given to the proceeds by the sellers of those assets. When the surplus income of the individual, instead of being used for acquisition of existing capital assets is not re-spent at all, but left idle on deposit in the banking system, the disruption of the flow, to that extent, is complete. In this second zone, then, we see that the flow of money into goods and services is tapped as an outcome of the disposition of individual income in certain forms,

with far-reaching and nefarious results in periods when compensatory factors are not operative in adequate measure.

In the third zone the flow is less readily traced. Profit of enterprise is an elastic term and we must be clear as to what we understand by it. It will be appreciated that the flow of money in the first and second zones has resulted in profits being made by enterprise through the funds that have come into its hands out of channels (1) (payment for goods) and (3*a*) (payment for the services of enterprise), also occasionally (3*b*) when ownership is exploited by enterprise (property companies). Those profits have been achieved in consequence of enterprisers, at each successive stage of production and distribution, asking more for their goods and services than the amount actually expended by them, or to be expended, in respect of the goods and services sold. The item of prospective expenditure includes necessary provision for foreseeable contingencies, which may not actually have arisen, but which will have to be met sooner or later, and which is chargeable to the period for which it is sought to ascertain the profit. As instances of such necessary provision may be cited the setting aside of funds for replacement and renewal of obsolete or outworn plant, installation and equipment, or for repayment of a relevant proportion of any debt incurred in the original acquisition of such fixed assets.

As against fresh provision of this type, made out of the money asked for current goods, but not immediately re-spent, there is to be set the disbursement of money for current goods out of past accumulations for similar contingencies. Hence, from the point of view of any disturbance of the circuit on this score, we are concerned only with a preponderance of new provision not re-spent, over past provisions actually utilised, or *vice versa*. I hope to devote some further observations to this aspect when dealing with reserves in a subsequent chapter, and will, for the present, assume that the amount, if any, included in the price asked for goods and services, which represents necessary subsequent expenditure in respect of the period for

which the profit is determined, is in fact promptly re-spent.

The profit of enterprise then involves the temporary withdrawal of money from the circuit flow, since more money is obtained for the goods and services sold than had been disseminated in respect of the same. To the extent that this profit is promptly restored to circulation amongst goods and services, no depletion of the flow arises. In so far, on the other hand, as this is not the case, a disrupting influence is introduced. It is therefore important to examine what happens to these profits. A portion, but not all, is normally distributed to those entitled to them (sole owners, partners or shareholders in enterprise, *i.e.* owner-enterprisers). This becomes the income of individuals *qua* owner-enterprisers. There is no distinction, as we have already pointed out, between this type of individual income and the others, previously referred to, in so far as the circuit flow of money is concerned. The same disrupting features characterise its disposition when re-spending takes the form of acquisition of existing capital assets or when it is not re-spent but left idle on deposit in the banking system.

The remaining portion of the profits of enterprise constitute " undistributed profits ". These are retained for the formation of voluntary reserves, or for the writing down of the book value of assets beyond what is strictly indispensable, or they are carried forward unallocated. We are concerned, however, not with the book entries to which the retention of profits gives rise, but with the manner in which the latter are re-spent. If existing securities are purchased with them or they are left to accumulate as bank deposits the disrupting effect upon the turnover of goods and services is identical with that resulting from the pursuance of a similar course by the individual in respect of his surplus income. On the other hand, if enterprise utilises the undistributed portion of the profits in the turning over of goods or the acquisition or construction of new buildings, plant, machinery, etc., or in the purchase of new securities, the proceeds of which are so used, there is no hitch on that

score in the circulation of money amongst goods and services.

There remains only one current in the circuit flow of money to be followed in its evolutions, *i.e.* the payments to Government, local and national (channel 3*c*). By and large, Government acts as a redistributing agency. The money it receives was part of the revenue and of the profit of enterprise, and part of the income of the individual. Its expenditure in the first place goes through the same channels enumerated earlier in this chapter. When revenue and expenditure are in balance there is no disturbance of the flow of money. Only when there is a deficit or a surplus is there a repercussion upon the circulation of money amongst goods and services. In the case of a deficit, fresh bank money may be created as a result of purchase by the banking system of the new Government securities or of the granting of loans against them. Of that new money the greater part is likely, in its distribution by the Government, to come into the hands of recipients who will utilise it as commodity money. Thus it will act as a counterweight to the reverse flow from goods and services into financial pursuits which, as we have seen, is a constant feature of the circulation of money. Even if no new money is created by the banking system to finance deficits, and the new Government securities are absorbed out of current surplus income, undistributed profit, or out of money previously idle, an influence is set up tending to arrest the normal drain away from goods and services. I do not, of course, suggest that deficits in Government finance are therefore to be commended. Though, under our present order, and from the point of view of money mechanics, their effect may be to counteract nefarious trends in the circuit flow, their ulterior reactions, if the re-establishment of equilibrium is not in sight within a reasonable period, are bound to more than wipe out any benefits that could accrue from the stimulation of the turnover of goods and services associated with deficit financing.

On the other hand, current surpluses applied to the purchase of existing Government securities for cancellation have the same effect as if the investment had been made

directly by the taxpayers who contributed to the surplus. Regarded by itself it is a disrupting factor in the interchange of goods and services, though, of course, the utilisation made of the proceeds by the sellers of the securities may modify its potency.

The circulation of money, then, so far from being a perfect circuitous flow, is tapped and drained at every twist and turn. If there were no counter-currents, the constant depletion of commodity money would produce chronic deficiency in relation to goods with resultant unceasing pressure upon the price of goods. The counter-currents, however, are operative only in times when it is generally anticipated that economic activity is likely to increase. So far as the flow of the existing volume of money is concerned, the expectation of better times ahead is reflected in the swelling of the active money currents out of previously idle money. This happens directly when owners of such money use it in turning over goods, or, indirectly, when securities are purchased with it, the proceeds of which are employed, by the sellers of the securities, in economic activity.

It will be appropriate at this stage to consider the money currents engendered by the financial system, which, so far, have been left out of the reckoning. These not only provide a fresh volume of money, but stimulate and swell the flow into goods and services and stir up the stagnant waters of idle money.

Normally, the banking system, apart from this creation of fresh money, can provide no antidote against the continuous tapping of the circuit flow, which, as we are now aware, is inherent in certain forms of the disposition of surplus income of the individual and undistributed profit of enterprise. In fact, the system, under our present order, is compelled to lend its facilities for the maintenance of idle deposits, and it is bound, in self-protection, to insist upon the cancellation of money by repayment of loans at a time when prices are falling and the flow is already severely attenuated.

At the bottom of a depression, however, the banking

system has been wont to exercise its power to create new bank money by acquisition of existing securities. Though this process serves to spread the trade cycle over a longer period, and to some extent alleviates its effects, it usually does not come into play until the slump has already assumed catastrophic proportions, and the inevitable reversal of this bank policy at a later stage is as potent an influence in initiating and accentuating the downward trend as was the creation of new bank money in arresting it.

On the chart the currents of new bank money originating in bank policy and in speculative borrowing are designated as " money expansion currents "; those representing the cancellation of bank money in pursuance of bank policy or through repayment of speculative loans are labelled " money contraction currents ". We shall trace their course through the general flow and thus gain an insight into their vital significance.

The expansion current, *i.e.* the purchase price paid by the banking system for the securities acquired by it, leaves the turnover pool through the channel leading to the reservoir of existing capital assets, raising the level of these latter and returning to the turnover pool as credit balances in favour of the sellers. Some part of this new money is likely at once to be drained away into idle account by being transferred to deposit account. By far the larger part, however, will, for the time being, continue to flow through the capital assets reservoir, absorbing securities and causing the currents in that reservoir to increase both in volume and in swiftness.

Yet another portion, small at first, but gradually growing by additions from the capital assets flow, will pass through the goods and wages and services of enterprise channels—in other words, will be employed in economic activity with stimulating effect.

Part of the stream running through the capital assets reservoir will, in its course, represent profit and will likewise be deflected to the economic activity channels. Thus a vitalising element begins to be diffused amongst goods and services. The distribution of the flow shows now some

modifications from the earlier pattern. The volume directed to the services of ownership, particularly interest, will be reduced as the level of the long-term rate of interest falls, whilst the flow into wages, goods and services of enterprise and Government swells. At this stage idle money, and newly borrowed speculative money, also enters into economic activity channels, accentuating the stimulus imparted by the creation of bank policy money. The human urge for expanding gain now governs developments. Anticipation of rising profits feeds the capital assets current, though its direction has, in the main, changed from fixed-interest-bearing securities to shares. Economic activity is simultaneously engendering its own currents of borrowed money for genuine self-liquidating trade requirements. These are not recorded on the chart, since they owe their creation to the growth in turnover and rising prices, and do not themselves constitute an originating cause of that growth.

The level in the turnover pool—the volume of deposits—and the velocity of the currents persistently rise. The capacity of the pool under our present order, however, being limited, it cannot accommodate both the bank policy money and the steadily expanding currents of economic activity. It is imperative that the latter, in so far as they are not speculative in character, should be left undisturbed. Hence it becomes necessary to drain away part of the contents of the turnover pool without calling upon borrowers to repay loans. This is done by the banking system sucking up out of the pool the proceeds of securities which it commences to sell from its holdings. In the first place, the bank money thus surrendered will mainly emanate from the capital assets channel. Partly, however, it may represent current surplus income and undistributed profit of enterprise employed in the purchase of existing securities, and thus the level in the economic channels too may be lowered. The level in the turnover pool begins to fall with repercussions over ever-widening areas. At first the drop in the level of the capital assets reservoir involves a rise in the long-term rate of interest, which is synonymous with a fall in the price of fixed-interest-bearing securities. We are aware, from

our survey in the preceding chapter, what are the consequences of this development. Declining confidence in the continuance of a stable or rising price level for goods will reduce the flow in the goods and wages channels, particularly, at first, those leading to constructional and other capital goods, with the result that in its subsequent circuit a lesser volume reaches consumption goods as well as service enterprises and Government. Repayment of speculative loans, both voluntary and under pressure from the banking system, drains off further money from the turnover pool. Payments for the services of ownership, being in the main fixed, cannot be promptly adjusted. Defaults in such payments become increasingly frequent, rendering the flow in this channel ever more sluggish. The constant and progressive reduction in the volume of money circulation and in its velocity of circulation is not counterbalanced by a corresponding diminution in the volume of current goods which it is called upon to absorb. Congestion and acceleration of the fall in prices ensues. The powerhouse of economic activity sends out ever weaker streams into the turnover pool. The shrinking contents of the latter become more and more stagnant. The depth of depression is reached, and it is not overcome until the renewed flowing of the spring of fresh financial water begins to reinvigorate the attenuated trickle to which the current in the channel of existing capital assets has been reduced. As pointed out, this is likely to happen only when drastic readjustments in the output of goods have been carried out with all their corollary of distress, privation and suffering. It is the limitation of the capacity of the turnover pool, *i.e.* the inability of the banking system, under our present order, to meet indefinitely genuine expanding trade demand for credit without the necessity of forcing up the long-term interest rate, that ultimately sets in motion the vicious spiral just described.

Quite apart from this destructive influence the crucial fact will have emerged from our survey that potential disrupting forces are inherent in certain forms of utilisation of the surplus income of individuals and the undistributed

profit of enterprise. We shall therefore require to examine more closely what man does with that part of his money of which the spending is optional and lies in his discretion, or in that of his representatives in the enterprises he owns, *i.e.* boards of directors. We shall thus be brought into contact with the problem of profits, reserves, savings, investment, insurance, interest and inheritance.

In our investigations into money economics we have so far presupposed a closed economy without external contacts. These latter, however, are of vital moment, particularly to a country such as ours, dependent for its existence upon its ability to sell enough abroad to pay for indispensable imports. We shall devote attention to that aspect later in the current section.

In concluding these observations on the flow of money I would emphasise that no partial reform which dealt with one or another of the features responsible for the periodic convulsions of the body economic could ever be effective. The three root causes which we set out at the commencement of this chapter form a compact and indivisible block. They must be tackled together in their entirety. However thoroughly all technical defects of the financial system were eliminated, however carefully and comprehensively production and distribution of goods were planned, failure to direct current surplus income into current goods would defeat all attempts at the permanent reconstitution of society at the highest level of material well-being consistent with the maximum utilisation of the productive forces of the nation. Towards that end it is essential that all obstacles to the maintenance of an even, continuous and vigorous flow of money into goods and services be removed.

Chapter 13

PROFITS

If our Lord were to come and sojourn with us again in the flesh and a pious but unscrupulous man of big business were to tempt Him in public, after the manner of the Pharisees of old, with the question: "Master, wilt thou tell us, is it lawful to make profits and what should the percentage be?" can we not imagine our Lord's dilemma. If He merely replied in the affirmative with, perhaps, a warning against profiteering, He would have set the seal of Divine sanction on an existing economic system involving injustice, corruption, oppression and moral degradation. In doing so, He would have doomed to the resignation of despair all those who imploringly looked to Him for deliverance from the appalling prospect of an immutable established economic order. On the other hand, if He were to denounce profits because of wrongs perpetrated in their pursuit and evils resulting from their misuse, He would be branded as a dangerous revolutionary intent upon the demolition of the material structure, without offering a workable substitute. As ever, He, knowing all that is in man, would address Himself to the motive, to the attitude of man towards God and towards his fellow-men. Can we not conceive the Master of Economy answering on these lines:

"Does not your Heavenly Father in His infinite bounty make the soil to yield its increase to the careful tiller? Does He not multiply the flocks to the faithful shepherd? Not gainful activity defileth a man, nor yet the extent of his gain. But defilement lurks all along the road he must walk to achieve his profit. And when he has made his profit let him give thanks to God and pray that he may be shown how to use it. Beware of covetousness! Take heed lest, in your greed, you harm one of my Father's little ones,

the economically weak, whose necessity gives you power over them. Glory not in material success, for God does not delight in worldly results, but rather does He delight in them that faithfully discharge their mission on this earth as stewards for Him. Woe unto him who tempteth his brother to serve two masters and maketh him to stumble, for God will surely require of him an accounting of gains achieved at the price of the soul of one of His children. And he who compelleth another to practice corruption, condoneth it or benefiteth by it, shall in nowise escape punishment.

"And ye, men of affairs, who by virtue of the high position to which ye have been called, control the resources of God's bounteous earth, there are amongst you wolves in sheep's clothing, who loudly proclaim their interest in the common weal, yet do not shrink from secretly conspiring to crush the competitor who stands in their way that they may the more readily impose their terms upon those who must needs buy from them; have ye forgotten what I told you: Unto whomsoever much is given of him shall much be required. In this world men may bend the knee to economic power, but know ye, God cannot be bought. Tainted gifts and legacies cannot avail the giver in the last day, unless they be the fruits of true repentance, evidence of a new birth."

Whilst, then, it is our belief that there is no divine injunction against gainful activity and—to go further—that there is no practicable alternative, it is equally clear that in its pursuit there can be no acquiescence in acts that conflict with the standards our Lord has laid down for the conduct of man to man. Nor can any course of dealing with profits be tolerated which, however well-intentioned and apparently innocent, can be shown to be prejudicial to the welfare of the community.

When we speak of profit we think mainly of the profit of enterprise. As already explained, profit in that sense is the excess of revenue over expenditure in respect of a given period, after all necessary provision for specific foreseeable contingencies, such as maintenance, repairs, depreciation,

obsolescence, renewals, etc., applicable to that period, has been allowed for.

Apart from the profit of enterprise, which is achieved in the normal course of the processes of production and distribution, we distinguish speculative profits on transactions, in commodities or capital assets, dissociated from the normal economic processes and entered into with the sole object of taking advantage of anticipated movements in price within a near future. Such speculative operations, as a rule, involve practically no turnover of money in payment for work done, and, moreover, they have a distorting effect upon prices, with undesirable reactions upon relative demand. They also tend to evoke a sense of injustice, particularly when, as is almost invariably the case, such speculation is carried out with money borrowed from the banking system.

Profits may also be made, under our present order, on the sale of capital assets, originally acquired not with a view to capital appreciation but for the purpose of obtaining a return on the money invested.

The feature common to all profits is that they can be made only by a larger sum being taken out of the flow of money than had actually been disseminated, plus any still to be disseminated in respect of the assets on which the profit is made.

Therefore, what concerns us from the point of view of the circulation of money amongst goods and services, is what becomes of that profit.

In so far as the profit of enterprise is distributed to those entitled to it, *i.e.* the owner-enterprisers, it becomes the income of individuals, just as the speculative profits and capital investment profits made by individuals. Its re-spending is entirely determined by the needs or the discretion of the recipients, in the same way as the income of the individual derived from work or received in consideration of the lending of capital assets (rent, interest, royalties).

Not all profit of enterprise, however, is distributed to shareholders or other owner-enterprisers. Part is, as a rule,

retained by the enterprisers or their representatives, the boards of directors, for the purpose of creating voluntary reserves. It is the disposition of that portion of the profits of enterprise which has an important bearing upon the interchange of goods. As to the distributed portion, we shall consider its disposition in conjunction with that of all other forms of individual income. Clearly, in so far as the income of the individual is completely re-spent upon current goods or services, whatever their nature, no disturbance in the circulatory flow of money is occasioned. We are, therefore, interested only in that part of the income which the individual determines not to re-spend upon goods and services and is, therefore, available for investment. We might, in a sense, look upon this surplus income as the " profit " of the individual. The greater the surplus, the more profitable he will consider his existence in the material sphere to be.

In subsequent chapters we shall deal with the various forms which the disposition of undivided profit of enterprise and of surplus income of the individual may take and their repercussions upon the economic position of the community. Here we shall endeavour to gain an insight into the mechanics of profits, indispensable to an understanding of money economics.

The effect upon the body economic of the retention of surplus income or undivided profit in the form of money (deposits) or of the employment of the same in existing capital assets, may best be illustrated by imagining a primitive, self-contained community, in which one person owns the means of production and raw materials and directs the productive process and the remainder render services of every description in this process. The banking system is communal, and loans are made only against the pledge of goods or other assets, for purposes of current production. The producer borrows £1000 on the security of his property to finance the production of goods. The whole of this sum is distributed by him in payment of services rendered to him in connection with the creation of goods from raw material to finished product. He retains for

himself such goods as he requires in compensation for his managerial services, say, to an amount representing original expenditure of £200. Apart from the goods, however, the producer desires to secure a money profit of, say, £100. He must therefore obtain for the remaining £800 worth of goods an amount sufficient to repay the bank the loan of £1000 and a further £100 to represent his money profit, *i.e.* a total of £1100. Clearly, this is impracticable since only £1000 had been disseminated in the productive process. Even if the recipients were willing to re-spend the whole of that income, only £1000 would be available. However, they, in turn, desire to retain as much as possible as savings in the form of money in the bank. As they find that they can satisfy all their necessities for the sum of £900, they withhold £100 from spending. Hence the producer succeeds in selling only about £650 worth of goods for £900. He is left with £150 of goods and a bank debt of £100. On the other hand, the servers have a bank deposit of £100.

So the banking system is unwittingly forced into an increase in its loans and deposits in comparison with what they stood at prior to the above transactions. Commodity money to the extent of £100 no longer circulates as such. The producer, in order to repay his loan from the bank, will now be forced to offer his unsold goods at a price which, if possible, should tempt the owners of the £100 to part with the money in return for goods. If he sells the whole of the remaining £150 worth for £100 he will at least be able to clear himself of debt, but a profit in money he cannot achieve in any case, and in the circumstances he would not even be in a position to retain for his own enjoyment any goods in addition to those he had previously retained. If a lesser reduction in price involving the sale of, say, £100 worth of the unsold goods for £100 proved sufficient to attract the £100 of money retained by the servers, the producer would at least have a profit of £50 in the form of goods over and above the goods he had kept at the outset. Should the servers, however, persist in their desire to retain the £100 in the form of a deposit, and should

the bank demand the repayment of the loan, the latter would have a bankrupt customer and a frozen loan.

Now, let us consider the alternative form of withholding current income from the absorption of current goods. Assuming the servers were prepared with the amount so withheld to acquire from each other, or from the producer land or buildings for instance, or other possessions, that money might be passing from hand to hand in payment of such possessions. Assuming, ultimately, the whole of that £100 reached the producer in exchange for part of his possessions, he would thus be enabled to repay his debt to the bank, but he would still have current goods unsold on his hands which would weigh upon the market and depress the value of further similar goods to be produced. Only if all parties had throughout been prepared to accept current goods, the producer taking his profit in that form and the servers converting their surplus income into goods, could the economic process have continued indefinitely without a hitch. Retention of profits or surplus income in the form of money, or utilisation of the same in the acquisition of existing capital assets, is practicable only at the expense of unsold goods and increasing bank loans, assuming that no countervailing influences, arising from the working of the financial system, are for the time being operative.

The cardinal distinction, from the point of view of the interchange of goods, between a barter economy and a money economy, lies in the effect of any decision not to take current goods in exchange for part of the product available for exchange. Under both systems goods fail to be interchanged, but under a barter economy that product would consist in goods, and it would be the maker of the decision who would be involved in the retention of goods. Having exchanged the bulk of the goods constituting his income for all that he presently required or desired, he would withhold the residue of his goods from exchange. Under our money economy, however, as we have seen from the simple illustration given above, the decision of the individual having a surplus income over necessities, or of

the controllers of undivided profits of enterprise, not to exchange for goods any part of these sums, entails for them the retention, not of goods, but of money, with the result that others, quite unconnected with their decision, are forced to retain goods unsold or sell at a loss. The intervention of money obscures the true significance of the decision to withhold any part of surplus income, or of undivided profits, from circulation amongst current goods and services. (As previously pointed out, the acquisition, from the issuer, of new securities, the proceeds of which are destined to be spent upon current goods and services, is assimilable in every respect to direct spending of that type.)

The doctrine that goods create the purchasing power needed to absorb them, or that supply is but the inverse of demand, would be perfectly true on two assumptions :

1. That all purchasing power disseminated in connection with the current creation and distribution of goods and services is re-spent in its entirety upon goods and services.
2. That goods and services of every description are created and made available, not at haphazard and without planning or co-ordination, but in just such proportions as conform to the relative demand, from time to time, for every category.

Neither of these assumptions is fulfilled in reality under our present order, and one of the fundamental causes of the recurrent economic depressions inherent in money economics lies in the facilities which the system affords for withholding part of current income and of undivided profits from any spending at all, by being left on deposit, or from spending upon current goods and services, by being employed in the acquisition of capital assets.

In certain circumstances an antidote is provided by the financial system as we know it, for, in contrast with the bank in our primitive community, it is in a position not merely to lend, but also to buy. When this latter prerogative is exercised, it permits investments, acquired by their owners with past profits or with past surplus income, to be

reconverted into new money. Some of this, as we have seen in the preceding chapter, in due course finds its way into the channels of economic activity. However, this compensating factor of liquefaction of past profits through bank policy is permitted to become operative only when ruthless readjustment of volume, and of money cost per unit of production, has brought the body economic to the brink of exhaustion.

Whilst it will be incumbent upon us to eliminate the disruptive elements in the circulation of money, it would be fallacious to assume that the fact that considerable numbers enjoy a larger income than required for the necessities of life, or that enterprise does not divide its profits up to the hilt, are in themselves unsatisfactory features. Nor is the investment of such surplus income and undivided profit to be condemned. It is essential, however, that the investment should involve the absorption of currently created goods, whether they be consumption goods or capital goods, new houses, machinery, plant installations, etc. In fact, it is desirable that such investment should entail an increase in the productive capacity of the community. It could not be seriously contended, for instance, that it would be preferable that investment should be in picture theatres, restaurants, businesses of middlemen, etc., rather than in manufacturing industries, building and constructional enterprise, etc. It is true that under the warped and distorted economic order under which we live, the benefit of additions to the productive capacity of the community has not only become obscured, but has been transformed into a positive menace, through failure to discern and remove the causes of cyclical depression. Under the order at which we aim, however, such an increase should ensure a constantly improving standard of material well-being, as obviously ought to be the case when the members of the community are willing to forgo immediate enjoyment of goods in order to create the means of increasing the future production.

Satisfaction at the existence of substantial layers of the community in receipt of income in excess of indispensable

necessities should not blind us to the deplorable condition of whole sections of the population who not only have no margin at all, but whose income is deficient for the maintenance of physical well-being. In a community whose intelligence and productive power would be capable of ensuring to all a high degree of comfort and well-being, we cannot, in any circumstances, acquiesce in this state of affairs. It is, however, not to be remedied solely by the elimination of the disrupting factors in the circuit flow of money. It involves the question of the distribution of income, in which the relative bargaining power and political influence of the different groups participating in the economic process plays the chief part. That this distribution, under our present order, in many directions fails to conform to our conceptions of equity is in no small degree due to the fact that both employers and employed are victims of an economic and financial system of which the fundamentals are imperfectly understood. They are thus impotent in the face of the periodic visitations which the defects of that system now entail, and which inflict heavy losses upon owners, whilst the unemployment that follows in their wake undermines the workers' power of resistance and bargaining.

CHAPTER 14

RESERVES

THE undistributed profits of enterprise constitute reserves. But they are not the only ones. In many instances voluntary reserves, not destined to meet specific foreseeable contingencies, are set aside before profit is established. Such voluntary reserves are, in all respects, identical with reserves made out of profits, in so far as the effects of their disposition upon the interchange of goods is concerned. Necessary provision, however, for expenditure anticipated in connection with the maintenance of the business of the enterprise at full efficiency is on a different footing, although the sums set aside for these purposes are often likewise designated as reserves. These indispensable provisions must be allowed for in the cost of the goods to which they apply. Failure to do so would affect future profits, or, if these were inadequate, would involve the concern in actual loss when the contingencies that ought to have been reserved against arose. Apart from this, such necessary reservation differs from voluntary reserves in this respect, that it is likely to be spent upon goods and services in a more or less near future, whereas voluntary reserves, frequently, are made neither in the expectation of their being required, nor with the intention of being spent upon goods, but rather with the object of strengthening the liquid resources of the enterprise. The effect of reserves, when maintained in liquid form, upon the flow of money amongst goods, as we shall see, is far-reaching and disruptive.

Reserves, whether necessary or voluntary, are either allocated to some specified purpose, such as depreciation, redemption of debt, obsolescence, repairs, renewals, dividend equalisation, etc., or left in an omnibus account such as " general reserve " or " reserve for contingencies ",

or altogether unallocated as "profit carried forward". Sometimes reserves do not figure at all, being deducted from the book value of the assets, which, however, is not material in so far as their effect upon the body economic is concerned.

On occasion the name of a reserve account indicates the source from which it is derived, instead of the object to which it is to be applied: for instance, "share premium reserve", which represents the surplus realised from the issue of shares at a price in excess of the nominal value.

What we are concerned with, in examining the significance of reserves to the interchange of goods, is not the names under which the reserves figure, but the utilisation of the money they represent.

It is not always clear when the term "reserve" is used whether liquid resources are intended, or reserves regardless of the way they are employed. In the former sense there is the danger that we confuse the possession of liquid resources with the possession of reserves. The two need not be synonymous. Reserves need not necessarily be represented by liquid resources, nor does the existence of liquid resources imply that there are reserves. An enterprise without any reserves may yet hold large liquid resources, and a concern with large reserves may hold none. I shall, therefore, use the term "reserve" to mean excess of book value of assets, after deducting liabilities, over the amount of the capital. Whether, and to what extent, the reserves shown on the books are in fact represented by assets will, of course, depend upon the relation between book value of the assets and their market value or realisable value; but that is an aspect we need not elaborate here. As will be seen, reference to "reserve" does not in itself give a clue to the way in which the reserve is utilised. The term "liquid resources" will be used to signify cash in hand, deposits in the banking system and marketable securities; and "liquid reserves" to denote reserves available in the form of liquid resources.

In order to demonstrate the effect of the creation of reserves upon the interchange of goods, we shall trace through

the financial mechanism the change of ownership and character of deposits involved in the process, with the aid of a simple example.

A manufacturer of motor cars calculates that the amount he has actually spent, or for the expenditure of which he has incurred liability, applying to a given period, for wages, salaries, materials, rent, interest on long- and short-term debt, if any, tools, etc., works out at the sum of £100 per car turned out during that period. In order to determine what the true cost price is, he must add to this an amount per car which, multiplied by the number of cars currently turned out during such period, will permit him to carry out, as, if and when necessary, all repairs, renewals, replacements and other operations required to maintain his plant, etc., at the required level of efficiency.

If he has borrowed to acquire plant, a reserve sufficient, if regularly repeated, to repay the loan at maturity or in the instalments agreed upon, may take the place of a corresponding part of the depreciation allowance. Let us assume that all these necessary provisions work out at £10 per car. Having thus established his cost price at £110, he will add such further amount as profit as will make the selling price of his car a suitable one in comparison with competitive makes. If we place this at £30 we arrive at a selling price of £140.

Seeing that only £100 had actually been, or is about to be, expended (we ignore relatively brief time lags throughout) by the manufacturer in the process of the creation of the car, where is the money to pay for £10 provision for contingencies and £30 profit to come from? We leave deliberate creation of new money by the banking system through purchase of securities out of consideration. Likewise we must not reckon with diversion into economic activity channels of previously idle money and of money previously circulating amongst securities or amongst other existing capital assets, for these factors are operative only under certain propitious circumstances. It follows that the £40 will have to be withdrawn from the money circulating amongst goods. This will deplete the amount available

for the absorption of other goods, which, as in the case of the cars, cannot be any greater than that expended or to be expended in the course of their own production. If no disturbance in the circulatory flow of money amongst goods is to be caused by this withdrawal, the money must be promptly restored to the commodity money circuit. What actually does happen?

A portion of the £10 to be set aside for necessary contingencies, say half, may be re-spent promptly on goods and services, and thus to that extent the deficiency made good and the money restored to its function of absorbing goods. But other of these contingencies are more remote and we will suppose that the reserve against them is left available in the banking account of the manufacturing concern. This means that £5 per car commodity money which was circulating as a result of creation of goods is now transformed into idle financial money.

Now as to the remaining £30 representing profit. The Board decides to distribute a dividend which works out at £15 per car. What the shareholders will do with this money, which will form part of their individual incomes, is for the moment outside our purview. It is probable, however, that part, at least, will not be re-spent on goods or services, thus to that extent causing further disturbance in the flow of money into goods.

There remains a balance of £15 which the Board, as representative of the owner-enterprisers, decide to place to reserve. What is done with that reserve is of vital importance. If new machinery, materials, new buildings, etc., are acquired with these funds, they will be returned to circulation as commodity money, and the deficiency occasioned by the withdrawal of a larger amount from the commodity money current than that disseminated in the process of the creation of goods will be remedied to that extent. In that case, however, it is clear that these reserves will not be available to meet future emergencies, as they will be represented by additions to the means of production and to stock-in-trade. The concern will be strengthened in the sense of having more assets and having its

productive and distributive capacity enlarged, and, when an emergency arises, it would be in a better position to obtain credit or fresh capital.

If, on the other hand, the voluntary reserves of £15 per car are left on deposit in the banking system, this results in the transformation of commodity money into idle financial money not made available for the absorption of goods. If they are invested in existing securities, they are, it is true, not stagnant, but they are likely to pass from hand to hand amongst owners of existing capital assets. This likewise involves the conversion of commodity money into financial money, this time with the effect of stimulating the price of existing capital assets. The only difference between the *necessary* provision of £5 unspent and the *voluntary* reserve of £15 not utilised to acquire goods is that there is no definite prospect or intention of the latter being spent at any time; though, of course, circumstances may arise which would induce the owner-enterprisers to convert the deposit or investment back into commodity money by acquiring goods with the proceeds.

So long as this is not done, however, the retention of these reserves in liquid form will have involved failure to make good the deficiency in commodity money occasioned by the fact that the manufacturer had taken out of the commodity flow more than he had disseminated in costs and dividend, with the probability of a further deficiency through a portion of the dividend not being re-spent on goods by the recipients.

The effect upon the interchange of goods will be that other goods remain unsold, as there is not enough commodity money to go round. Furthermore, part of the loans which the banking system has granted in connection with the creation and distribution of goods cannot be repaid. Thus loans will stand at a higher figure than previously, and, on the other hand, deposits will have increased by the money retained by the manufacturer or circulating amongst security owners. This has become financial money and is not made available for the repayment of commodity loans.

To form a clear idea of the increase in loans and deposits

thus forced upon the banking system, let us assume that only operations of a similar character in the economic interchanges are carried out simultaneously, and that, beginning at the first stage of creation of goods, they successively pass through the stage of distribution to wholesalers, distribution to retailers and distribution to consumers. We will further assume that we find the banking system with £1000 millions of deposits, resulting from cash holding of £100 millions, purchase of bills and loans against bills of £300 millions and purchase of investments to the amount of £700 millions, the excess of assets being accounted for by capital £100 millions.

The producers now start to create goods and require loans of £800 millions, which are disseminated amongst suppliers of materials, workers, etc., as we have explained in the chapter dealing with the circulation of money. Deposits now are £1800 millions and the assets show an addition of £800 millions under the heading of loans. The manufacturers now dispose of the goods created to the wholesalers for £900 millions which the latter borrow from the banking system. The manufacturers repay their loans for £800 millions and leave £100 millions on deposit. The deposits are now £1900 millions, *i.e.* the original £1000 millions, the further £800 millions disseminated in the productive process and the £100 millions owned by the manufacturers. The loans are now £900 millions and the wholesalers are the debtors. They, in turn, sell to the retailers for £1000 millions which are obtained in the form of loans from the banking system. The wholesalers, out of the proceeds, repay their loan of £900 millions and retain their profit of £100 millions on deposit. The banking system now has loans of £1000 millions owed by the retailers, and deposits of £2000 millions, composed of the original £1000 millions, the £800 millions distributed in the creation of the goods and £100 millions each owned by manufacturers and wholesalers respectively representing their profit. Now the retailers desire to dispose of the goods which cost them £1000 millions for £1100 millions. Neither the manufacturers nor the wholesalers are disposed to spend their profits. There is,

therefore, only the £800 millions originally distributed in the creative process available, as the £1000 millions of deposits which we found in existence at the outset are all idle. The retailers thus will be unable to dispose of the whole of their goods even if the recipients of the first £800 millions were inclined to spend the whole of it, which they are not, as they too wish to save £100 millions and leave these on deposit. So the retailers sell for £700 millions about £640 millions of goods, being left with £360 millions unsold and a bank debt of £300 millions (£1000 millions borrowed less £700 millions repaid). The position of the banking system now is that the deposits are £1300 millions as compared with the original £1000 millions and the assets are increased by loans to the tune of £300 millions. The additional £300 millions of deposits represent the undistributed profits of manufacturers and wholesalers and the surplus income and undistributed profits of the individuals and enterprises to whom the original £800 millions were paid.

Although the example, necessarily in such a complex problem, is crude and excessively simplified, it illustrates the effect upon the position of the banking system and upon the interchange of goods of profits and surplus income retained in money. Since reserves are merely part of the profits if they are voluntary, and, in any case, whether voluntary or necessary, represent part of the money taken out of the money flow in excess of what was put into it, the example covers reserves maintained in the form of money in the banking system.

Now if the owners of the £300 millions of additional deposits in our above example were to decide to purchase securities with this money, and the sellers of these securities in turn bought others, and so on, there would be no direct alleviation of the pressure of unsold goods, but there would be a rise in the level of securities. The only way in which the goods position and the debtors' position could be relieved and the banking position restored to the *status quo ante* would be the decision of the owners *pro tem.* of those £300 millions to purchase goods.

Against the formation of additional liquid reserves we

must offset the utilisation of liquid resources already held by enterprise in the acquisition of goods. This involves the conversion of idle bank deposits into active commodity money, or the conversion of securities into money in order that the proceeds may be disbursed in the purchase of goods. Clearly, the money transferred to the enterprise that thus disposes of its securities, if it had previously been on deposit, is in this way put into circulation amongst goods, and constitutes an addition to the commodity flow just as the transfer of the enterprise's own deposit from idleness to activity. If previously it had been circulating amongst goods and represented current surplus income or undivided profit of some other enterprise, no diversion from the commodity flow arises. Therefore, the use of past liquid reserves in the purchase of goods in whatever form either counteracts diversion from the commodity flow, or actually introduces additional money into the flow. What concerns us is any excess of fresh reserves retained in liquid form, over the utilisation of past liquid reserves for current goods and services, or *vice versa*. Normally it will be found that, in times of economic activity, fresh reserves tend to be utilised in the business of enterprise as well as past reserves previously kept liquid. In times of depression, on the other hand, additions to reserves may not be as great, but they are less likely to be employed in the turning over of goods. Nor is it probable, at such a juncture, that the sellers of the securities in which such additions to reserves would be invested would use proceeds in economic activity. At the same time, the countervailing influence of conversion of past liquid reserves into goods would scarcely be in evidence. Thus the incidence of the disrupting element involved in the increase of liquid reserves is most pronounced when the opposite trend would be most needed.

In so far as reserves are concerned which represent necessary provision for definite contingencies certain to arise, and which are calculated as part of the cost since they must be allowed for by all makers, it is probable that, normally, these will exceed the amount spent, not only because of the tendency to make more than adequate pro-

vision, but because, with increasing means of production, the contingencies to be reserved against become progressively greater. Thus a gradual growth of liquid reserves constituting necessary provision is likely to be in evidence.

Is there then no compensating flow of financial money into commodity money to offset the drain of commodity money to financial uses resulting from growth of liquid reserves ? Clearly, this occurs only when there is an inducement for financial money to transform itself into commodity money—when it is held that the depressing factors are no longer in the ascendant. The creation of additional money by the banking system through purchase of securities, which presumably will have been preceded by adjustment of output of goods, will provide this stimulus, as we have seen in earlier chapters. In due course, this will also be followed by the creation of more commodity money by the banking system at the behest of borrowers engaged in the processes of production and distribution. Whilst this additional commodity money does not provide the means of absorbing unsold goods since it must be repaid, it nevertheless eases the position, as unsold goods will form a smaller proportion of total turnover of goods, and there will be more inducement for past profits in the form of idle money and for current profits and surplus income and new financial money created by the banking system to be employed in current goods.

Whilst the maintenance of reserves in liquid form must be recognised as one of the causes of disruption in the process of absorption of goods, I do not suggest that reserves should not be made. It is clearly prudent and desirable that all likely contingencies, at least, should be provided against. Inasmuch, however, as certain forms of employment of such reserves can be shown to be in conflict with the true interests of the community, it is necessary that these should be discontinued. It is one of the many instances where the welfare of the commonwealth is prejudiced by actions innocent and wholly commendable when regarded solely from the selfish standpoint of the interests concerned.

But, as we shall see in due course, the community is not powerless, when it recognises this conflict and its far-reaching evil effects, to devise means whereby the needs of enterprise over its entire range can be brought into harmony with the attainment of the highest standards of material well-being of the public at large. I cannot emphasise too frequently that no combination of stimulating factors operative at times of prosperity has proved either sufficiently powerful to secure work and a decent existence for all capable of working, or sufficiently lasting to avert the inexorable relapse into the throes of depression and suffering which characterises and disgraces our present system.

CHAPTER 15

SAVING, INVESTMENT AND INSURANCE

WE now turn to the surplus income of the individual, in other words his excess income over necessities. From the point of view of the flow of money it is to be likened to the undistributed profits of enterprise. In volume, however, it is vastly greater. As in the case of undistributed profits, no disturbance of the money circuit arises in so far as the surplus income is spent upon current goods and services. Surplus income, spent, for instance, upon entertainment, travelling at home, purchase of luxuries, construction, or purchase from the builder, of new houses, etc., continues thus to be utilised in the turning over of goods and services.

Not so, however, with that part of surplus income " saved " in forms involving its diversion from the circulation of money amongst goods and services. There are three forms of saving, in the wider sense of that term, which are disruptive of the money flow, viz. :

1. Non-spending, or saving in its narrower sense. This includes hoarding of actual cash and keeping surplus income in the form of deposits in banks or savings banks.
2. Spending upon the acquisition of, *i.e.* investment in, existing securities or other existing capital assets.
3. Spending upon the provision of capital for future contingencies by means of insurance in its numerous diversifications.

Savings deposited with building societies, in so far as the latter re-utilise them in loans for the financing of new building, do not involve disturbance of the circuit flow of money amongst goods and services, nor does investment in the form of direct participation in enterprise or of

purchase of new securities when issued by enterprise, assuming that the proceeds are destined to be re-spent upon goods and services. It would, however, be unwarranted for savers or investors who happen to follow this course to pose as benefactors, since they do no more than restore to the circuit flow what had been withdrawn from it by them.

Before we examine the far-reaching and nefarious effects upon the body economic of those forms of saving which involve the withholding of money from the circuit flow amongst goods and services, let us consider the intrinsic character of the human urge to save. In contrast with other manifestations of instincts inherent in the nature of man it does not aim at gratification of immediate desires, but, in a measure, is a subordination of these latter to a stronger impulse. In some of its aspects this overruling impulse is not altogether selfish, though often tainted with a large element of possessiveness and pride. What Christians want to resolve for themselves is the question whether saving is in conflict with God's will, which alone must ever be the criterion by which our actions are tested. Our Lord's injunction, " Lay not up for yourselves treasures upon earth ", etc. (Matthew vi. 19-21), under modern conditions has lost some of its telling significance, for present-day treasures are immune from corruption and plunder, so obvious a menace in the days when saving could only be done in the form of hoarding. Yet, in its essence, the warning is as profoundly needed now as ever. We may paraphrase it to fit present-day money economics as follows : " Lay not up *idle* wealth for yourselves, for in so doing you undermine the foundations of social and economic order, leading inexorably to destruction of your treasures ". The injunction applies to " idle " wealth only because the employment of surplus income in ways which entail its being spent upon current goods and services is not prejudicial to the common weal.

We do not cease to marvel at the omniscience revealed in the scant utterances of Our Lord on the subject of the material order. He showed Himself as truly the Master of Economy as He is Master and Lord in every area of

life. He gave no circumstantial explanation of economic phenomena. He did not decry this or that specific defect or abuse in the financial system, nor did He lay down any specific directions as to how the interchange of goods and services was to be conducted. Yet in all His teaching and in the parables dealing with material aspects of the existence of mankind, He went straight to the root of the factors responsible for all the misery and suffering originating in economic causes, by exposing the fundamental antagonism between God and Mammon.

Then, as now, the wilful or ignorant defiance of His revelation of the divine conception of the material order carried in its wake disruption of the interchange of goods and services and inequitable distribution of God's bounties. What in modern parlance is euphemistically designated as the " trade cycle " is but the sophisticated counterpart.

It is, however, not against the possession of income in excess of necessities that our Lord inveighed. Nor is it conceivable that He would have preferred the man who spends an income, in excess of needs, on self-indulgence, without making any provision for foreseeable contingencies, above another who forgoes immediate enjoyment of part of his income in order that he may not become a pauper in contingencies that are within the range of possibility. And would Our Lord wholly commend that man's generosity who gives away his entire surplus income, but fails to provide against emergencies from which he, or his family, cannot expect to remain exempt, and who is forced to borrow or beg when they arise ? Rather is it my belief that our very income is part of God's provision for us, and that its allocation as between spending and saving can never be a matter for the law to determine, but is one of stewardship of our worldly goods, to be the subject of prayer and to be placed under God's direction. The object of the law-giver must be to see that no transaction into which the individual may enter, in seeking to make legitimate provision for the future, shall conflict with the interests of the community.

To appreciate the havoc wrought when any part of surplus income is not re-spent on goods and services, it is

necessary to keep before us the fact that the money disseminated in the process of current production and distribution of goods and services of enterprise is all that is available for their absorption, and that all current income of individuals is one of the stages in the flow of this money. Diversion of some of this income to other purposes must therefore inevitably bring about ultimate breakdown of the economic interchanges.

The direct increase of commodity money through additional loans by the banking system for the financing of the normal economic processes, is not in itself a correction of any deficiency in commodity money brought about by the withholding of part of current income from spending upon goods and services. The whole of this new borrowed commodity money would be needed to absorb a volume of goods and services equivalent to that created and distributed with its aid, just as the volume of previously existing commodity money was required for the goods and services in the creation and distribution of which it had been disseminated. The flow can be supplemented only in two ways, as we have seen in previous chapters :

1. By creation of new bank money—
   (*a*) As a result of purchases of securities by the banking system. Part of this money, by the process described in earlier chapters, gradually converts itself into commodity money.
   (*b*) As a result of new loans granted by the banking system for speculative purposes. This must be repaid, but so long as it is in existence it will tend to swell the volume of commodity money—directly and to its full extent, if used for speculation in goods; indirectly and partially, if applied to speculation in existing capital assets.
2. By the conversion into commodity money of existing idle bank money, *i.e.* stagnant bank balances, and of existing financial money, *i.e.* money circulating in the turning over of existing capital assets.

Source 1 (*a*), dependent upon bank policy, as we are

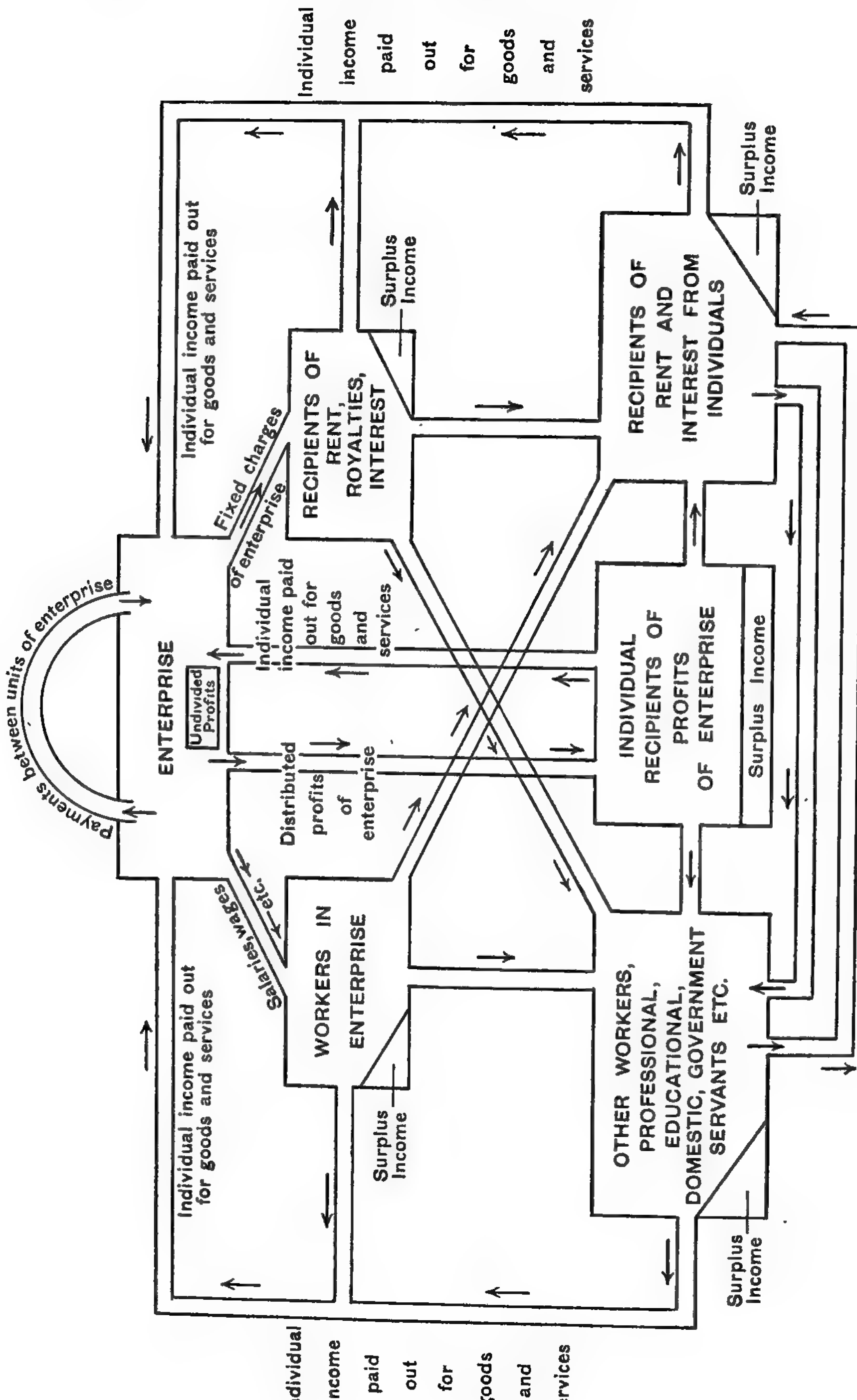
aware, begins to flow only after the depth of depression is passed, and the others require the stimulus of a rising price level or increasing turnover.

Clearly, it would be futile, in probing into the causes of disruption of the economic interchanges, to allow for corrective influences that become operative only after the destructive factors have brought about breakdown and crisis. We must consider the commodity flow stripped of its stimulating features. The time we must select for this purpose is one when the banking system is not in a position to add to the total volume of bank money, when, within the total volume of existing bank deposits, there is no inducement for owners of idle deposits to use them actively in turning over goods and services; when money circulating amongst existing securities, or other existing capital assets, is not tempted away from this pursuit by expectations of profitable employment in trade; in brief, when there is no tendency to supplement the existing flow of commodity money from other sources.

If we are satisfied that, at such a time, none of the current commodity money flow can be dispensed with, and that all current income of the individual represents a stage in that flow, we shall have no difficulty in appreciating that any diversion by the individual of part of his current income from the absorption of goods and services inevitably produces a deficiency in the money available for this absorption. The result is unsold goods and unpaid bank loans, with the sequel of progressive disruption of the process of production and distribution of goods and services.

The fact that the source of income of the individual is not always directly connected with the money paid out in the production and distribution of goods and services of enterprise tends to obscure its origin. The appended chart (p. 144) may facilitate an understanding of the interrelationship between the various categories of individual income.

Only income of the individual has been considered. Payments as between enterprise have been ignored, as ultimately these must be reflected in the income of the three groups directly identified with enterprise, viz.



FLOW AND DIVERSION OF INDIVIDUAL INCOME

income *qua* worker in enterprise, income *qua* owner-enterpriser and income *qua* owner of capital assets used by enterprise. It is clear that unless all money received by all five groups distinguished on the chart finds its way back to enterprise, the goods and services it turns out cannot, in their entirety, be absorbed. As we have seen in the previous chapters, enterprise itself, through retention of part of the profits in the form of bank balances or investment in existing capital assets, diverts part of the money it receives from the five groups of individuals from circulation amongst goods and services. However, the volume of individual surplus income diverted through saving, investment and insurance is vastly greater.

A word may be said about the income of individuals arising from the re-spending of Government revenue. There is one item included in the latter which is not derived from current revenue or current profit of enterprise, or from current income of individuals, but from capital. I refer to Estate Duties. In so far as the payments of such duties is effected out of proceeds of assets bought with money that was not, at that time, circulating amongst goods and services, or that did not represent current surplus income or current undivided profit, there is an addition to the commodity money flow. On the other hand, purchases of securities by Government for the sinking fund must be offset against this.

We will now briefly examine the effect upon the body economic of each of the three forms of abstention from direct enjoyment of current goods or services which the individual practises.

Saving in the sense of non-spending may be accomplished in various ways, which differ in nature and potentiality of disturbing the interchange of goods. Most deleterious in its consequences is saving in actual currency, commonly called hoarding. We have dealt with its incidence in our survey of the financial mechanism in the First Section. If no fresh gold is acquired by the central institution to counteract the withdrawal of currency from its function as a base of credit, such saving will involve not

merely the withholding of commodity money from its proper use of absorbing goods and services, but will impose upon the banking system the necessity of contraction of credit many times the amount hoarded.

The destructive effect thus is not confined to the depletion of the circuit flow by the amount hoarded. Through the cancellation of an additional volume of money by the banking system the disruptive process is accelerated and paralysing forces are released in the body economic.

Saving by leaving money idle in the banking system is detrimental to economic activity only less in degree than hoarding. Like the latter, it immobilises current commodity money needed if current goods and services are to be paid for, and turns it into stagnant financial money. With the consequences of this method of dealing with surplus income we are familiar from our survey of the disposition of undivided profits of enterprise in the preceding chapter. Pressure on the price of goods, decline in economic activity and impairment of the banking system's capacity to extend fresh loans are inevitably entailed.

If the money saved is transferred to a savings institution, and the latter maintains an account in the banking system, it means that the ownership and right of disposal of the deposit concerned is transferred to the savings bank. The latter cannot, of course, use it in the acquisition of goods and services. To the extent that it is spent upon purchase of existing securities the effect will be the same as if the saver had done so himself. Should the savings bank wish to maintain part in actual currency in its till as a reserve against the new deposit, a loss of cash to the banking system would be occasioned, forcing restriction of credit of many times the cash withdrawn as above described, in order that the pre-existing proportion of reserve to liabilities may be restored. Thus, apart from the withdrawal of the money "saved" from use in absorbing goods and services, we have to reckon with further cancellation of money, inevitably accentuating the disruption directly caused by the deposit of surplus income with the savings bank.

If the savings institution has its account at the Bank of England, as, for instance, is the case with the Post Office Savings Bank, the first effect of the transfer of the money to the Savings Bank would be the loss by the banking system of a balance at the Bank of England and an equivalent decrease in deposits. Within the Bank of England only a transfer from "Bankers' deposits" to "Government deposits" or to "Other deposits" would be involved. The banking system's balance at the Bank of England, however, would be restored again to the extent that securities were bought by the savings institution from sellers carrying their banking accounts in the banking system. As the Savings Bank would presumably not invest the deposit in its entirety, there would, however, on balance be a loss of reserves to the banking system through reduction of its balances at the Bank of England.

Thus the same necessity to contract liabilities in order to restore the proportion of reserves to deposits would arise. If the savings institution withdrew part of the uninvested balance of the new deposit in actual currency from its account at the Bank of England, and if we assume that the latter desired to maintain existing proportions of currency to its own liabilities, the result would be a cancellation of credit by the Bank of England by means of sale of securities. In the first section of this book the mechanism of such contraction has been fully analysed. Deposits of the banking system at the Bank of England would decline, which would impose upon the banking system further contraction of liabilities to an extent many times as great as the amount withdrawn in cash by the savings bank from the Bank of England. Thus, where the savings bank has its account at the Bank of England, the prejudicial effect from the point of view of interchange of goods is intensified, the cash immobilised by the savings bank in its till being, in that case, money of the first grade. (See Chapter 5, "Three Grades of Currency".)

All the methods of saving, in the sense of non-spending, which we have considered above, entail not only the withholding of money from absorption of goods and services,

but the setting up of forces which impose credit contraction or hamper credit expansion.

Now let us consider spending of surplus income of the individual upon *Investment*. This involves the transfer of the disposition of surplus income to the sellers of the assets in which the money is invested. If the seller is an enterprise disposing of new securities with a view to re-spending the proceeds on goods and services, there is, at that stage, no disturbance of the money flow. Investment of surplus income in new buildings of every description, either by having these constructed or by acquiring them from the builder, likewise produces no disrupting effect. When the investment consists in existing securities, however, or land or existing buildings, there is every likelihood that the sellers will in turn use proceeds for similar purposes at a time such as we have premissed at the outset, offering no special inducement for fresh enterprise or speculation. Thus the commodity money, instead of continuing to circulate amongst goods and services, will now pass from hand to hand amongst owners of existing capital assets, with all the prejudicial effects of depletion of the commodity flow.

Investment in National Savings Certificates requires special mention. On the surface it would appear that these are assimilable to new securities issued by the Government. If this were so, and it were assumed that the proceeds were re-spent by the Government on goods and services of one kind or another, there would be no disruption of the commodity money flow, because the current surplus income utilised to acquire Savings Certificates would thus be restored by the Government to the circuit. However, any excess of fresh purchases of Certificates over encashments is not applied by the Government to expenditure on goods and services, but on purchases of securities for the sinking fund. Thus the effect is similar to that of direct purchase of existing securities by the investors themselves. When, on the other hand, encashments exceed new purchases of Savings Certificates, there is, on balance, an addition to the commodity money flow, assuming that the proceeds of the

Certificates encashed are expended in their entirety upon goods and services, and that the Government borrow in order to raise the money required to repay the excess. In any case, even if borrowing is not necessary and the effect of the repayment is merely to reduce the amount available for sinking fund, it will, to that extent, have counteracted the depletion of the commodity flow which sinking fund purchases betoken.

Finally, let us briefly consider *Insurance*. We must exclude " accident " insurance, that is, insurance against all the current risks that beset members of the community in their daily activities. In that type of insurance the insurer merely is an enterprise supplying a service, in the course of which the premiums received are redistributed in payment of claims and payment of current expenses, except for such surplus as may be achieved constituting the profit. To that surplus all we have said concerning profits and reserves applies.

As a form of saving we are concerned only with life insurance in its manifold and ingenious combinations, and such other forms of insurance which involve the payment of regular premiums to assure capital sums payable at some future period. Payment of the premiums would normally be effected out of current surplus income. The money would be invested by the insurer in order that, together with compound interest, the accumulation may, on the average, be adequate to meet the payments covenanted and to leave a surplus to the insurer. Life insurance is a hybrid form of saving. Part of the premium constitutes payment for the assumption of a risk by the insurer: the risk of death of the insured supervening before the average anticipated date. The balance provides for the capital payments the insurer has undertaken to make. There is a constant growth in the investment of insurance companies, and so long as the aggregate sums insured continue to increase, the current premiums, together with current income from investments in the life fund and after allowing for current expenses, are likely to exceed the disbursements in respect of policies that have become claims by the death of the insured or the

advent of the date stipulated in the insurance policy. Apart from their expanding business, the practice followed by insurance companies of retaining a substantial proportion of current profits undistributed is a further factor in the constant accretion of the funds of insurance companies available for investment.

The current revenue of insurance companies, *i.e.* premiums and interest, is part of the commodity money flow like all forms of current income, in circumstances such as we have assumed, when the money flow amongst goods and services is not supplemented from sources that do not directly spring from an increase in the production and turnover of goods and services. The excess of this current revenue of insurance companies over disbursements is invested and, to a minor extent, left on deposit in the banking system. The bulk of the investment would normally be in existing securities, and represents, therefore, diversion of money from circulation amongst goods and services. But there is more. The amounts disbursed under policies which have become claims represent capital to the insured, and only a part is likely to be used by them for current expenditure on goods and services. Thus it is not solely the difference between current revenue of the insurance companies and amounts disbursed in current expenses, claims and dividends which we have to consider from the point of view of the circuit flow of money, but a further unknown sum representing disbursements under policies reinvested by the recipients. It is probable that the total thus withdrawn from the current commodity circuit of money, as a result of life insurance transactions, would bear some resemblance to the annual life premiums paid. In 1936 these aggregated close upon £140 millions.

It is not, of course, suggested that the provision for the future vouchsafed by insurance should not be made, nor that insurance companies should not strengthen their reserves. It is, however, imperative that, under a new order, this commodity money, indispensable for the maintenance of the current interchange of goods, shall be redirected into productive channels.

In view of the magnitude of the sums withdrawn from the commodity flow, transactions arising from saving, investment and insurance constitute a powerful factor in the disruption of the economic interchanges to which our present order is prone.

Alas for the complacency and indifference which permits crisis upon crisis to advene and continues to depend upon uncontrolled forces, such as the creation of new money by bank policy, to counteract the ravages wrought by the disrupting elements. Until we are fully persuaded that some of these are inherent in our money economics, and resolved to put an end to their sway, we shall in vain attempt to stem successive tides of economic upheaval, with their corollary of chronic unemployment, defective physique and shaken morale. Sacrifice will be involved in that decision, for we must be prepared to surrender what we falsely regard as our essential right to unfettered discretion in the disposition of our money. Failure to offer it may cause our present order to be submerged and leave the landscape desolate when the tide recedes.

CHAPTER 16

INTEREST

IT is not with payment of interest as such that we shall be mainly concerned in this chapter, but with *changes* in the trend of interest rates and especially in that of the long-term rate.

All payment of interest is but a rotation in the turnover of money disseminated in the process of production and turnover of goods and services.

To the borrowing enterprise, interest constitutes an element in the money cost of the goods and services it supplies. To the individual recipient of interest it constitutes current income ; to the enterprise receiving interest it is current revenue ; to the Government, payment of interest on its debts is one of the forms under which current revenue is redistributed.

The payment and receipt of interest is not in itself a cause of disturbance of the circuit flow of money amongst goods and services. From that point of view it is completely assimilable to any other kind of income of the individual or revenue of enterprise. In the revenue of certain types of enterprise, for instance, Banks, Investment Trust companies and Insurance companies, interest looms large. Their business does not involve to any extent the re-spending of current revenue upon goods or services of enterprise, but for the most part their revenue is re-distributed in other ways. It is the disposition made by the recipients which matters so far as the circuit flow of money is concerned. To the extent, however, that the revenue is not re-spent upon current outlays and obligations, or in dividends, the concerns themselves are in a position to influence the money flow by the way in which they utilise this residue, just in the same way as is the case with enterprise of any other category. The individual whose income

consists mainly or solely of interest likewise is in no different position from any other individual. It is in certain forms of disposal of his surplus income that the danger to the commodity money flow lies, as we have seen in the preceding chapter.

There would, then, have been no occasion for devoting special consideration to the subject of interest, were it not that changes in the long-term rate are a vital factor in the composition and circuit flow of money. The repercussions of those changes upon the material welfare of the community are highly significant. They have already been dealt with in previous chapters, though emphasis was laid more on the mutations in the interplay of money currents than on the problem of long-term variations in interest rates themselves. We may preface our observations on that subject by a few general reflections on interest.

There are those, including Moslems, who genuinely hold that interest should neither be charged nor received, on spiritual grounds. Clearly the charging of interest is a violation of the spirit of our Lord, where a loan to relieve a personal need is involved (Luke vi. 32-35; Luke xiv. 13-15). In many cases, moreover, what is asked for in the form of a loan to avoid the humiliation of soliciting a gift ought, if conceded, nevertheless to be regarded as a gift by the lender. If, then, the taking of interest on such loans is rightly to be condemned, it will be realised how utterly vile usury is. No civilised state should tolerate it. No one, for instance, reading the report of the plight of millions of families in India who find themselves in the clutches of money-lenders, can fail to be roused to deep indignation against those vultures and can help feeling disillusioned with a Government that has failed to sweep away, root and branch, an evil which undermines the mental and physical well-being of numbers of our dark brethren. The lot of the serf under a humane master would be preferable to theirs. Once unemployment and lack of social legislation have forced them to turn to the usurer, they sink year by year more deeply into debt owing to the extortionate interest demanded. Here is an opportunity for " new men " in high

places, whose love for their fellow-beings is strong enough to stir them to action that will once and for all put an end to such glaring exploitation of the weak.

Interest on money lent to the enterpriser, who seeks to utilise it in production or distribution of goods or services with a view to deriving a profit from those activities, is on a different footing, provided, of course, that the rate charged conforms to the prevailing level of interest current for the type of loan involved, and leaves scope for a fair margin of profit to the enterpriser for normal effort and ability.

Here a common misconception may be corrected. The buyer of an evidence of indebtedness (bond, debenture, mortgage or whatever may be its description) is not necessarily a lender. He is a lender only when the money paid by him goes to the borrower. In all cases he is an investor and a creditor; but when the evidence of indebtedness is acquired from an existing owner, the investor is not a lender. It is desirable to make the distinction, because investors are frequently under the impression that their funds are being used by the debtor enterprise and are thus fulfilling a useful function. Except in circumstances as above mentioned, this is not the case, and all that the investor has done is to give the disposition of his funds to the previous owner of the security. In the vast majority of cases, in times which offer no special inducement for fresh ventures, that money is likely to continue to be withheld from use in absorbing goods and services and will merely change hands as between owners of existing capital assets.

In view of the large number of those who, as depositors or borrowers, at one time or another come into contact with the banking system, a few comments on bank interest may be in place. A good deal of controversial discussion has centred round this subject. Some hold that no interest should be paid by banks on deposits, and that the resultant saving to the banks should be passed on to borrowers in the form of lower interest charges. There have even been suggestions that a charge should be made by the banking system for keeping deposits, and that borrowing should be free.

I have had experience in the course of my banking activities of a charge being made for deposits. But this was in a backward and primitive country where abject poverty prevailed, where social legislation and care for the economically weak was practically unknown, where solvent borrowers were rare and the standard of living deplorable, and where the bulk of financial transactions had to be carried on in cash. In that community the great difference in credit standing between the large number of banks in existence forced the weaker ones to hold out inducements in the shape of interest to attract deposits, whereas others required a fee for accepting deposits in order to deter would-be depositors from inundating them with cash for which there was no suitable outlet without running what they considered to be undue risks. It is not an example from which a highly organised and civilised commonwealth could learn much. A charge on deposits in a community of the latter type does not appear to have much to commend it. It would lead to hoarding and encourage speculation, since owners of bank money are unable, of their own volition, to make this money disappear, and suitable productive employment, under our present system, may not be available.

It is true that the retention of surplus income in the form of bank deposits is fraught with gravely prejudicial consequences to the community, but, as I have repeatedly pointed out, isolated steps intended as correctives of single features, admittedly pernicious though they may be, are futile and can only lead to making confusion worse confounded. The evil is an integral part of a complex and delicate system which must be dealt with as a whole.

On the other hand, there seems no good reason why interest should be paid on deposits. If all banks agreed to pay none there could be no danger of wholesale transfer of deposits from one bank to another, and hoarding is not likely to be resorted to on any scale merely because deposits ceased to earn any return. Under our present order, however, so long as there are separate banks they are likely to continue offering an inducement to owners of deposits to leave them for a fixed period or subject to agreed notice.

There is an advantage to each institution in knowing that a given volume of deposits will not be transferred to another bank for a given period and that there is no risk either, during that period, of transfer of the deposit by its proprietor *pro tem.* to another owner who might have his account at another bank and transfer the deposit there. The advantage consists in being able to plan ahead with greater knowledge. It is erroneous to suppose that deposits give the banking system, taken as a whole, the use of the money. Deposits are there because the banking system has acquired or lent against certain assets, and the right to use the deposits lies with the owner, not with the banking system. Such use may involve payment to others who have their account elsewhere. If then an owner notifies the bank that he does not intend to use his deposit for a given period, this information is worth something to the bank, as it implies the assurance that, to this extent, the bank will not be called upon during that period to contract a corresponding volume of assets. If no interest were paid, under our present system, there would be no incentive to the owner of the deposit to give this information to the bank. It is clear, too, that at a time of high short-term interest rates, when withdrawal of deposits from a bank would necessitate contraction of assets yielding a high return, the consideration banks are willing to offer for advance notification by owners of deposits concerning their intentions would be greater. If there were but one bank, any justification for payment of interest on deposits would cease, as deposits could not be withdrawn except through hoarding, against which safeguards could be devised.

However, the question whether or not interest on deposits should be paid is not vital in any sense from the point of view of the interchange of goods and services, which is our paramount concern. As the banking system would be obliged to pass on to borrowers any advantage derived from non-payment of interest to depositors, competition would soon force producers and distributors of goods and services, in turn, to give the benefit of the lower charges to consumers where possible. Whilst prices thus

may fall slightly, there would be a correspondingly reduced volume of commodity money to absorb the goods and services, for depositors would have ceased to participate in the circuit flow of money. The only direction in which some benefit might be experienced would be in exports, but as interest constitutes so small a proportion of the cost of most current goods it is doubtful if this would help much.

The mere taking away of income from one category of members of the community in order that others may have more does not remedy fundamental defects and frequently produces undesirable reactions. It should be confined to such cases where equity unmistakably requires it.

Now we come to our main theme: changes in the trend of interest rates, particularly long-term rates. The long-term rate prevailing at a given time represents the annual cost to enterprise or other borrowers of obtaining the use of money as debtors for long periods. Normally the money so borrowed is utilised for non-self-liquidating purposes, that is, for the creation or acquisition of capital assets. The long-term interest rate cannot, of course, be expressed in a single percentage. It differs according to the financial position of the borrower, his past record of integrity, political conditions, economic prospects and other criteria by which the risks involved are judged. The long-term interest rate also governs the remuneration which owners of money, for the time being, expect for venturing their capital permanently as owner-enterprisers (shareholders). In view of the greater risks involved, this return should be higher than that on money lent, but as anticipation of prospective higher dividends is often discounted it is not always so in reality.

The money available at any particular moment for investment in long-term loans, or in shares, can only be derived from current or past surplus income and undivided profit. When the banking system buys securities, reconversion into bank balances of past invested surplus income takes place, not on the initiative of the owners of the securities, but on that of the banking system. At such times the volume of past surplus income and undivided

profits, previously invested, but now reconverted into bank balances, and available for long-term or permanent investment, is large. Hence solvent borrowers need not pay dear for the transfer of such balances to them for long periods. In other words, at such a time the long-term interest rate is low.

When the cost of such borrowing changes in an upward sense, disruptive trends are set up in the body economic.

There are two contingencies in which this becomes unavoidable under our present system—other conditions remaining unchanged :

1. When the limit of credit expansion of the banking system is reached.
2. When the international balance of payments is persistently adverse.

The former arises from our exclusive dependence upon gold as the basis of our credit system ; the latter from haphazard, uncontrolled and unco-ordinated international transactions by the individual, for which, in the aggregate, the nation is forced to shoulder responsibility.

We have fully explained the working of our credit system in the First Section, and all I need say here is that, in the past, full employment of our national productive forces has never been reached before the banking system has found itself at the end of its tether. In other words, the time comes when, in relation to reserves held, the banking system has attained the maximum of liabilities it can safely assume. Then, unless further gold is acquired by the Bank of England, or unless money returns from circulation on a large scale, or the Bank of England expands its own liabilities by purchasing securities, thus strengthening the reserves of the banking system, no further credit can be granted by the banking system except by recalling money for the time being not engaged in turning over goods and services. It does so through the sale of securities.

In times of economic activity the demand for trade loans will continue to increase, for man is bent upon ever expanding gain. It is a demand the banking system is

bound to satisfy, and its only means are the sale of securities, consequent cancellation of deposit money and reissue of that money in the form of loans. Money available for absorption of securities becomes ever scarcer; its cost rises, reflected in a fall in the market value of securities. The banking system, compelled to accept lower prices for its holdings as it continues to sell, is bound to seek compensation for the loss of yield on the assets sold, by raising the cost of the new self-liquidating trade loans to the borrower, and so the rate for short-term money rises in sympathy. The scarcity and high cost of financial money raises a barrier to new construction, for, not only are current prices of goods high at the crest of an upward swing in economic activity, but on this high cost the increased annual charge for interest on long-term money borrowed would have to be allowed for, and prospects of adequate future profits would not be favourable. Thus the vicious circle fully described when dealing with the circuit flow of money is set in motion. The disrupting factors of undistributed profits and surplus income withheld from absorption of current goods and services are allowed free rein, until the collapse of the interchange of goods is complete.

In the second contingency, *i.e.* a persistently adverse international balance of payments, the same ultimate necessity for contraction of liabilities arises under our present system. Either gold must be exported or the exchange value of the pound depreciates. Gold exports impose upon the financial system the obligation to curtail its outstanding liabilities (deposits), and from our survey of the inner workings of the system in the First Section of the book we are fully familiar with the mechanism of this process. Even, however, if gold were not exported and the pound allowed to become worth less, we might ultimately be forced, in the absence of any control over international movements of goods and money, to resort to the disastrous device of forcing a decline, or preventing a natural rise in price level, in order to stimulate exports and discourage imports. Under the gold standard we acquiesced in this procedure as if it were ordained by immutable destiny. That a

decline in prices of goods and services is inexorably brought about through the medium of a rise in the long-term rate of interest we have seen. The mere raising of short-term interest rates on loans by the banking system could not achieve this end. This would only entail a change in the distribution of money circulating in connection with goods and services. More would go to depositors, in the form of interest on deposits, and more would be asked by enterprise for their goods and services, though it might not be in a position to recoup the whole of the additional charge from consumers. The banking system might have a larger margin of profit between the rate charged and allowed, and, in so far as this would be redistributed in the form of additional dividends, no disruption of the flow of money would be occasioned. To the extent that the extra interest charge was not passed on to consumers by enterprise, shareholders in the latter would—*ceteris paribus*—see their income reduced in favour of the owners of the banking system.

Moreover, an increase in short-term loan interest rates may have some distorting effect upon interchange of goods, as it affects different categories of goods unequally, as well as different enterprises within the same groups, according to whether they are working predominantly with their own capital or with borrowed bank money. These discrepancies would, however, not necessarily involve a reduction of interchange of goods on balance. A more direct method of forcing a decline in prices through scarcity of short-term money would be a refusal by the banking system to renew loans and disinclination to grant fresh ones. It is inconceivable, however, that the community would submit tamely to this in order that imports of goods and export of capital might continue unchecked. Nor would inflow of temporary capital from abroad, *i.e.* the transfer of domestically owned bank balances to foreign ownership attracted by high short-term rates, solve the problem of depreciating exchange value of the pound in any permanent sense. Hence, in the last analysis, it is the banking system's power, under our present order, to create and cancel money by purchase or sale of securities, which

enables it to achieve, through the rate of interest for long-term money, the adjustment rendered necessary by an unbalanced international payments account.

Sometimes the course of interest rates is represented as the outcome of elemental forces over which man can exercise no dominion. That is untrue. Interest rates are entirely a product of man-made policies, and under the system which has governed our economic destinies in the past it has often been the policies followed beyond our national borders that have determined the shaping of our own.

The defects in our credit mechanism, our failure to apprehend the baneful consequences of diversion of commodity money to financial uses, and the unfettered freedom that enables the individual to commit the community in the field of international payments, regardless of the sufferings this may entail for his fellow-beings, those are the features to which must be ascribed the fact that so often in the past we have found ourselves at the mercy of extraneous forces, apparently irresistible and immutable. Our only answer to these was the device of contraction of the interchange of goods through the medium of high interest. Let us not again put our necks in the noose!

An essential requisite of a new order that shall not be subject to the ordeals associated with the existing one, must include stability of the rate of interest by the elimination of the causes that provoke fluctuation, and at a level which shall not unduly favour ownership as against personal effort.

Chapter 17

INHERITANCE

So far we have, in this section, considered the implications of man's dealings with his money during his lifetime. The power of the individual to dispose of his possessions, however, does not end with death. Subject only to payment to Government, in the form of taxation, of part of the value of the assets composing his estate, he is, under our present system, practically untrammelled in the right of bequest. He can depart from this world in the assurance that the wishes he had expressed in that respect, in valid form, will be carried out by survivors.

Our concern, in the main, has been to trace the effect upon the interchange of goods and services of the transactions to which the disposal of surplus income and undivided profits give rise. Estate left on death represents accumulated surplus income. The change of hands at death involves, in one respect at least, a change in the circuit flow of money. I refer to the payment of death duties. In other respects the unfettered right of bequest raises problems of a different character, to which I will allude later.

Much is heard of the view that death duties have a destructive effect upon capital. What there is in this will emerge from an examination of the mechanics of the money transactions associated with the payment of death duties.

If the assets of the estate include bank balances sufficient to pay for the death duties, all that is necessary would be the transfer of the ownership of such balances to the Government. Since death duties form part of the current revenue of the Government, the amount would be disbursed as current expenditure. Thus, past surplus income which was, for the time being, idle on deposit is distributed to recipients, who are likely to utilise the bulk in paying for

goods and services (Government servants, suppliers, etc.). There is thus an addition to the flow of commodity money with stimulating effect upon the demand for goods and services, counteracting to that extent the vastly more powerful factors working in the opposite direction.

In the majority of cases, however, it is unlikely that bank balances would be owned by the deceased estate to an amount sufficient to defray death duties. Hence assets have to be realised. The buyers of these assets, in turn, can pay for their purchases only with bank balances. Ownership of a bank balance available for investment means the possession of current or past surplus income, or undivided profit. It is immaterial whether that profit or surplus income had, from the outset, been retained in the form of a bank balance or invested and subsequently re-converted into money. At the time that these balances are tendered in exchange for the assets sold by the deceased estate they are not circulating amongst goods and services. By their transfer to the deceased estate and from the latter to the Government, in payment of death duties, these balances are redistributed as Government expenditure and pass into hands that are likely to re-spend the funds largely in goods and services. Hence a stimulating factor is introduced in the circuit flow of commodity money. In so far as the balances used to buy the assets sold by the deceased estate represented current undivided profit or current surplus income, needed to absorb current goods and services, a potential disrupting element would have been counteracted by the redistribution through death duties, as above explained.

Clearly, however, if death duties were unduly high and caused the volume of existing capital assets that came on offer for account of deceased estates to increase disproportionately, having regard to the volume of current undivided profit of enterprise and current surplus income of the individual available for investment, the money value of those assets must depreciate. This might be temporarily obscured in a period when the banking system was creating new money by purchase of securities, but in endeavouring

to gauge the significance of each specific feature of our money economics we require to analyse it as if it were isolated and all the money factors remained for the time being *in statu quo*. Hence we must assume that neither the flow of money amongst goods and services, nor that amongst capital assets, is altered or diverted from any cause not associated with the particular hypothetical development which we are examining.

If the drop in the value of capital assets through constant excess offer developed into a chronic trend, the rate for long-term money would be permanently upward, with the effect of barring the construction of new capital assets and gradual paralysis of the entire body economic, as we have seen in earlier chapters.

Whilst, then, there is no direct disturbance in the circuit flow of money so long as the aggregate of existing capital assets offered for sale in exchange for bank balances required to pay death duties were kept within reasonable bounds, there would be artificial stimulation of the flow of money amongst goods and services if the offer of capital assets were excessive. That stimulation would be achieved at the expense of the depletion of money circulating amongst existing capital assets, with resultant drop in the value of these latter. Two discrepant currents would be set up : increased demand and higher prices for current goods and services, with declining value of capital assets. The stimulus to consumption industries would be short-lived, and the ultimate breakdown of the economic structure could not be warded off for long as the money yield of excessive death duties progressively declined, capital goods producing industries languished, and new capital for any purpose became prohibitive in cost, if obtainable at all.

The effect of death duties upon the body economic is entirely a question of degree. Even when the scale is moderate, however, and the money redistributed by the Government in respect of the same is only part of the amount that would have been available for current investment, there is a point of broad principle that merits

consideration. We may feel that it would be preferable if the money received as death duties from sale of existing capital assets by deceased estates were re-spent by the Government upon new capital assets instead of being redistributed as current expenditure. It would restore the money to the circuit flow amongst goods and services just the same, only the nature of the goods produced would be different in that more capital goods and less consumption goods would be needed. Whilst some readjustment would be necessitated as a result of reduced expenditure by the Government in certain directions, there would be no diminution in total turnover of money as compared with the present system, under which all revenue is redistributed on current expenditure, except to the extent that securities are bought for sinking funds. If reproductive capital assets were created with the revenue representing the proceeds of existing capital assets, the community would be the richer for it in assets and potential future productive capacity. In fact, if we lived under an order in which diversion from the commodity money flow were rendered impossible, it would clearly be undesirable for the Government, by current spending of proceeds of capital assets, to stimulate a flow that had not been depleted, and if any part of its revenue were derived from such a source it would be essential that a corresponding amount should be redirected to existing capital assets by increased sinking fund purchases.

However, the existing order leaves free rein to the disruptive factors in the money flow. So long as there is no check upon the diversion of undistributed profit of enterprise and surplus income of the individual to purposes which involve their being withheld from spending upon goods and services, so long it cannot be a matter for concern, and, in fact, is rather to be welcomed, that part at least of the money so withheld is attracted through death duties into the coffers of the Government and redistributed so as to render it probable that the bulk will be used in acquiring current goods and paying for current services.

Now let us consider the subject of inheritance from a

different angle. Is it right and just that, through inheritance, a section of the community, already privileged in opportunity and enjoyment of worldly possessions, should have their advantages continued through the generations, and in some cases progressively enhanced through ever-growing accumulation of their share in the means of production? It is wholly reasonable that we should desire those near and dear to us to derive benefit from effort made, good fortune enjoyed or frugality practised—though the latter virtue should not be permitted, as we are aware is the case at present, to prejudice the welfare of the community. On the other hand, it cannot be in the interest of the community as a whole that, through the sole accident of birth, kinship or other relationship to the testator, some should be called upon to exercise control over affairs for which they may not possess the necessary aptitude, inclination or experience, be set in authority over others and be enabled to impose their will upon the latter. Moreover, where the income from the estate is such that not the whole of it is required for current needs of the beneficiaries, there is every likelihood, under our present order, that by the disposition of the balance in forms involving non-spending on current goods and services disrupting factors in our money economics will be perpetuated.

It would, of course, not accord with our sense of social justice to see the brother who departs from this world deprived of the assurance that the assets of which he dies possessed should serve to free his widow or dependents from material care in so far as possible. It will be well for us to remember, however, that we are not placed in this world solely for those near and dear to us. Our mission in life is a much wider one than that (Luke ix. 59-62; xiv. 26). There are vast numbers that may be far less favoured by fortune than our dear ones. There must be many—perhaps far more than we think—who would derive great joy from the thought that they were working for less privileged ones besides their own kith and kin, and that the bounties God bestows upon them will in time redound to the permanent benefit of those others also. Inequality

is inherent in human life. There is no reason, however, why it should be unreasonably extended beyond its confines.

The New Order must aim at harmonising the legitimate desires of the human soul with the true welfare of the community. There is no room in the "new man" for narrow possessiveness, exclusiveness and pride.

CHAPTER 18

FOREIGN TRADE

WE now turn to the international aspects of our money economy.

Just as we distinguished in the case of purely domestic transactions two kinds of money, so we group the money operations involved in the settlement of international economic intercourse under two main heads, viz.:

1. Relating to current international interchange of goods and services and fulfilment of current obligations.
2. International financial operations involving the transfer from one country to another of current or past undivided profits and surplus income (capital movements).

The mechanism through which all international payments are settled is provided by the foreign exchanges.

In this chapter we shall deal with the first and overwhelmingly the biggest group. It is true financial operations unconnected with goods, particularly since the War, at times loom large amongst international interchanges. They have a potent bearing not only upon the financial and economic position of the countries directly concerned, but of the world at large. Nevertheless it will be preferable to leave them out of account here, and deal with them separately, in order that the ramifications of current trade, visible and invisible, may be examined divorced from other considerations.

Foreign trade in its wider sense comprises both visible and invisible items. The former consist in import and export of goods of every description, including gold, which in many countries occupies the special dual position of commodity and basis of currency and credit. The invisible

items include services rendered and current obligations discharged in money by individuals, enterprise or Government in one country to individuals, enterprise or Government in another. In their effect upon the machinery of settlement and upon the domestic money flow, the invisible items are assimilable to import of goods from the point of view of the country which has to make payments abroad, and to exports from that of the country which receives the payments from abroad.

Amongst services rendered between individuals, enterprise and Government of different countries rank shipping and other forms of transport, insurance, banking, catering to foreign visitors, acting in the capacity of technical experts, advisers to foreign interests, etc. Current international obligations include interest and amortisation on money borrowed from abroad, and profit on money ventured by foreign interests.

Remittances of emigrants to dependents in their country of origin, as contributions to their maintenance, may also, in a sense, be looked upon as the discharge of an obligation, though not necessarily a legal one.

We realise thus the vast range of international financial relationships covered by foreign trade in all its ramifications. There is scarcely a phase of national policy which does not directly or indirectly have a bearing upon it. However, the scope of this survey must be limited to tracing through the money mechanism the financial transactions arising out of foreign trade and their repercussions upon the material well-being of the community. We shall find that an interchange of goods and services which, allowing for current international obligations, is balanced, involves no problem of money mechanics and permits of indefinite expansion, subject only to the needs of the community for products and services from abroad and to its ability to supply in exchange the goods and services acceptable to foreign communities.

Lack of equilibrium in current international interchanges, on the other hand, distorts the domestic money circuit and has injurious effects upon foreign trade.

It may be helpful first to illustrate by a simple example

the money transactions to which the settlement of balanced current international trade, visible and invisible, gives rise. It should enable us to grasp more readily the significance of persistent discrepancy in that intercourse.

An importer in Great Britain has purchased goods from an exporter in the United States. Payment may be agreed upon in one of the following ways :

1. In the form of a balance in the banking system of Great Britain.
2. In the form of a balance in the banking system of the U.S.A.
3. In the form of a balance in the banking system of a third country, say the Argentine.

The first two alternatives are identical in their effect. In case number one the importer in Great Britain will instruct his bank to credit the account of the American exporter (or the account of the latter's bank—it is immaterial which). The American exporter will offer this sterling balance in exchange for a balance in the American banking system, for that is where we assume the American exporter will need his money. In case number two it will be the British importer who will do the offering of the sterling balance in exchange for a bank balance in the U.S.A., for he has agreed to pay in dollars. In both cases the buyer of the sterling balance will be someone who is able to command a dollar bank balance, and is desirous of exchanging it for a sterling balance. As mentioned, we ignore, for the time being, transactions arising from capital migrations and confine ourselves to those associated with current trade, visible and invisible, and the discharge of current obligations. Hence the sterling balance sought by the owner of the dollar balance is required to pay for goods bought by, or services rendered to, him by individuals or enterprise in Great Britain, or for current obligations which he has to meet in Great Britain (*e.g.* interest or amortisation on money borrowed from, or dividends on money ventured by, parties in Great Britain). The dollar balance thus is transferred in the American banking system from the account of the

American importer, or debtor as the case may be, to the credit of the American exporter, who, in this way, receives payments for the goods he had supplied to enterprise in Great Britain. In the British banking system, the sterling balance which the British importer is obliged to part with will be transferred—by order of the American importer or debtor who has acquired it—to the credit of the parties in Great Britain who have supplied goods, or rendered service, or to whom the money is owing in respect of interest or dividend. The changing hands of bank balances in both countries has left the domestic flow of money in each undisturbed.

The transactions involved in the third method of payment, *i.e.* by a bank balance in a country other than the two directly concerned, are a little more complicated but in essence identical. In our example we have assumed that the British importer has to pay the American exporter with a peso balance in the Argentine banking system. The American exporter may have stipulated for this mode of payment because he himself imports goods from the Argentine and needs pesos to pay for them, or he may have greater confidence in the stability of purchasing power of pesos than of dollars, and, as payment for his export to Britain will not be received for, say, three months, he prefers to be paid in a money of which he expects that it may be worth more and certainly will not be worth less in terms of dollars than at the time the export transaction is concluded. Whatever the reasons for the condition that payment is to be made in pesos, the British importer has to find someone willing to part with a peso balance in the Argentine banking system, and to take a sterling balance in exchange, for instance, an Argentine importer of goods from Great Britain or a British exporter of goods to the Argentine.

If, as we have assumed, our foreign trade, visible and invisible, is in equilibrium, and we disregard capital movements, demand for sterling balances must equal the supply. The current international payments between each country and each other country need not necessarily be balanced, and hence it is not certain that for every offer

of a sterling balance in exchange for a peso balance there will always be an owner of a peso balance seeking to exchange it for a sterling balance. If one is found the following transfers are made in the banking systems:

In Great Britain: from British importer to the credit of British exporter or creditor.
In the Argentine: from Argentine importer or debtor to the credit of American exporter.

The American exporter now either uses the peso balance to pay for his own imports from the Argentine, by having it transferred to the credit of the Argentine exporter, or he sells it to an American importer against a dollar balance in his own favour.

If no seller on suitable terms of a peso balance in exchange for a sterling balance is found by the British importer, or by his bank on his behalf, a balance may be acquired in the banking system of some other country which is known to export to, or to be a creditor of, Argentine interests. This latter balance may then more readily be exchanged for a peso balance. Such indirect acquisition of the peso balance, however, does not change the fundamentals in any way. Nor does the intervention of banks and dealers in foreign exchange; and we have, therefore, disregarded them in our analysis. It merely occasions the interposition of intermediate transfers of balances in the banking systems concerned to temporary owners.

It will have emerged from the foregoing observations that equilibrium in the international balance of payments of a country is merely another way of expressing the fact that demand for balances in its banking system by interests wishing to acquire them in exchange for bank money elsewhere equals the offer of such balances by owners seeking to obtain foreign bank balances.

If every country had a balanced international payments account there would be similar parity of international demand and supply of balances in the banking systems of all countries, and stability in the value of currencies in terms of each other would reign.

Looking at international trade from the point of view of the domestic money flow, we find that, in this sphere too, an equilibrated current international payments account produces no disturbance of any kind. The volume of money circulating amongst goods remains unchanged, and the amount required to absorb all goods within the country likewise. The injurious effect of lack of equilibrium lies in the distortions of the money flow in relation to goods and services which it carries in its wake. This will become apparent from a scrutiny of the manner in which imports and exports and other items in the current international exchange of payments impinge upon the money circuit.

When goods are imported there has, in contrast with domestically produced goods, been no previous dissemination of money within the country. Hence there is no commodity money in circulation to absorb them. The importer, to pay for the goods, must borrow from the banking system, involving the creation of new bank money, or must use an existing balance not at that time employed in turning over goods. This latter procedure also would, for the time being, constitute an addition to the commodity flow. If the importer sold the goods first, others would have to obtain money from these same sources, or if they did not and used current commodity money there would not be enough money left to absorb the whole of the goods within the country, including the imported goods. We have, however, premissed corresponding exports, so the commodity money used to pay for the imports is transferred to the exporter. Whatever the origin of this money, the former relationship between the volume of the circuit flow and the volume of money required to absorb all the goods within the country, is now restored, and the banking system's position is as it was prior to the import. If the money paid by the importer for his goods was derived from a bank loan he will be able to repay it. The export of goods, equivalent in amount to the import, has reduced the volume of money required to absorb all goods within the country to its original amount, *i.e.* that put into the circuit in the normal processes of production and distribution. Hence

the additional money represented by the loan will no longer be required. If the importer had used an idle bank balance or one previously engaged in turning over securities it can resume its former status without disruption of the money flow amongst goods and services.

Finally, if the importer had paid for his goods out of current commodity money received from the domestic buyers, that money will now, in the hands of the exporters to whom it is transferred, serve to pay for an equivalent amount of goods exported. The circuit is complete and the process may be repeated indefinitely.

Mostly, however, equilibrium in the current international balance of payment is coincident with inequality between import and export of goods and services, the difference being accounted for by payments in discharge of current international obligations. Few countries have no items of the latter type amongst their current international payments accounts. This makes no difference so far as the effect upon the domestic money flow is concerned.

So long as the aggregate of current payments to be made abroad is equal to the aggregate of current receipts from abroad, there is no hitch in the domestic flow of money. Where excess imports of goods are offset by payments received in discharge of current international obligations, the *distribution* of the money flow, however, is somewhat different from that above described, where we had assumed a balanced international payments account solely resulting from exchange of goods and services.

As we have already analysed above the position in so far as imports are countered by exports, we need now only consider imports in so far as paid for out of money owing by foreign debtors in respect of current obligations such as interest, dividends, amortisation. The total volume of money required to absorb the goods available within the country is greater than that disseminated in the course of domestic production and distribution because the value of goods exported is less than that of the imports. The domestic bank balances which the importer has to provide to pay for the excess imports, and which either constitute, as we

have seen above, an addition to the commodity flow or are diverted from the absorption of other current goods, are acquired by the foreign debtor in order that he may meet his current obligations. Instead of being transferred to exporters of goods, they are transferred to those entitled to the payments from abroad, *i.e.* bondholders, shareholders, partners in foreign enterprise, etc. We will presume that the recipients re-spend these sums fully upon current goods and services. Thus, whatever the origin of the money paid by the importers for the excess imports it is restored to the commodity flow after the temporary diversion to the creditors in respect of current obligations due to them from abroad.

Again, then, there is no disturbance of the circuit flow of money and no factor which militates against such invisible items in the current international balance of payments being settled in the form of imported goods. In fact, as we shall see, it is the only form in which they can be settled without disruption of the normal interchanges, both domestic and international.

There is yet another aspect connected with international trade which deserves the most careful consideration. Vital though it be to any country that its current international balance of payments shall be permanently in equilibrium, it is essential, if its foreign trade is to be wholly beneficial, that the goods and services imported shall be such as would willingly have been taken in exchange for those exported had the entire foreign trade been centrally directed on behalf of the community as a whole. Under our present system this is not consciously done, and, with the exception of some sectional and disjointed efforts at control, the volume and nature of imports is, by and large, left to individual enterprise without cohesion or co-ordination. Nor is any conscious attempt made to provide for equilibrium in foreign trade, visible and invisible. How grave this is will be apparent when we consider the effects of lack of balance in the international interchanges of a country.

First let us survey the consequences of a persistent excess of imports over exports, including invisible items on

both sides. The facile theory that imports beget exports has been given the lie by experience. It belongs to the same category as that which holds that demand is the inverse of supply, or that goods create the purchasing power needed to absorb them. Half-truths all, which have validity only under hypothetical conditions which we have failed to create and from which reality is far removed. We know that adverse balances of current international payments have persisted in different countries for several years in succession.

So far as the domestic circuit flow of money is concerned, the offer of balances in the domestic banking system of the country having an excess of imports, visible or invisible, by owners desirous to exchange them for balances abroad, must inevitably exceed the demand on the part of owners of the latter willing to part with them in return for a bank balance in the country with excess imports. To the extent of the surplus offer, foreign exporters or other foreign interests acquiring the exporters' balances will become owners of bank balances in that over-importing country. Those balances, foreign-owned, will, under a full gold standard, and always ignoring capital movements, eventually be withdrawn in the form of gold. Meanwhile they are not available for circulation amongst goods and services, and there will, to that extent, be a deficiency in commodity money as compared with the goods to be absorbed. All that was available for that purpose was the money disseminated in the domestic process of production and distribution, together with any new commodity money utilised to finance the excess imports. We are only concerned with the latter, for, in so far as imports and exports cancel each other out, we know that there is no change in the composition and volume of the circuit of money, nor in the amount required to absorb the goods within the country, available for absorption.

To the extent of the excess imports or, more precisely, to the extent that the amounts currently payable abroad exceed those currently receivable from abroad, domestic bank balances have passed into foreign ownership and will

not be used for the purpose of taking up goods. Sellers of the latter are confronted with a deficiency of commodity money. Unsold goods and unpaid bank loans result. Internationally the foreign-owned bank balances, equalling the deficit in the current international payments account, will pass from one foreign owner to another at declining prices in terms of the foreign owner's own money. Soon a level is reached at which the foreign owner, by converting his balances into gold at the fixed price prevailing in the gold standard country, having that gold shipped to him and selling it in his own country at the fixed price in force there, receives more than he would by selling his balance in the banking system of the over-importing country at market price. The banking system of that country which loses the gold is forced to contract credit, and to the depressing factor above mentioned is added one much more drastic in its incidence, that of cancellation of bank money by sale of securities on the part of the banking system and by a policy of restriction of loans. We have described in previous chapters the devastating effect on the body economic of this policy. Imports will now indeed balance exports, not as a result of any begetting of exports by the surplus imports, but by the decrease in demand for imported raw materials and other goods resulting from economic depression. Ultimate equilibrium is established, but at a lower level, and at distressing cost in unemployment and privation.

The automatic mechanism of the international gold standard does not function in a country with a managed currency. The outward symptom of persistent excess of imports would be the depreciating trend of the value of the money of that country expressed in the money of other countries. The reason for this depreciation, as we are aware, is the offer, without corresponding demand, of bank balances in the banking system of the over-importing country, just as we have found to be the case in a gold country in similar circumstances. Under a managed currency, however, there are no means whereby these foreign-owned balances can be liquidated, except ultimately in goods and services. Hence, until the value of the money of that

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country, in terms of others, falls to a level at which it becomes profitable for the owners *pro tem.* to convert their balances into goods and take these in payment, so long will these balances pass from hand to hand at ever falling prices. Of course, we must continue to assume that the economic and financial *status quo* in other countries is not disturbed from causes unconnected with international trade, and that the effects of the lack of equilibrium in the current balance of international payments of the country with surplus imports is not obscured by capital movements. In other words, we must consider the excess imports in isolation, on the hypothesis that all other things remain unchanged. In a sense, of course, the fact that these foreign-owned balances resulting from excess imports cannot be liquidated, in itself involves a capital movement. To that extent foreign capital has temporarily, at least, emigrated to the country with a deficitary current international payments account. The movement, however, is involuntary and results directly from the disequilibrium in the current international interchanges of the country concerned. The foreign-owned balances are likely to be left on deposit in the banking system or temporarily invested. In neither case would they be circulating amongst goods and services.

The effect upon the domestic circuit flow of money in the first instance is similar to that under a gold standard. Soon, however, the fact that the foreign-owned balances cannot be withdrawn in gold begins to tell, both negatively in obviating the contraction of credit associated with gold exports and positively through the absence of a limit upon depreciation of the value of the money in terms of other moneys. This latter factor will involve a rising tendency in the cost of all imported goods which is bound to be reflected in the cost of living generally in the country with persistent excess of imports. The rise will stimulate domestic production and cause ever-growing demand for commodity money. This will be satisfied by expansion of bank credit and by use of non-active money or of money previously engaged in financial pursuits. The initiative in

the domestic interchange of goods will increasingly lie with buyers, and the factors which tended to keep prices down are easily overshadowed. A conflict is set up between domestic economic trends and the course of that country's international interchange of goods. To rectify the persistent over-buying abroad—which we have premissed—a fall in the cost of domestic goods expressed in terms of foreign money is indispensable in order that exports may be stimulated. This means that domestic prices ought to rise less in proportion than the value of the money in terms of foreign moneys falls. Against this desideratum domestic developments militate. Prices will be lifted above the level at which the corrective of increased exports and restriction of imports would have been fully operative. Thus domestic prosperity combined with over-imports and insufficiently elastic exports will continue until the limits of credit expansion in the banking system are reached. Such limits, in a country where gold, though unavailable for export, is still the basis for credit, are more or less well defined. When attained, the entire vicious spiral of sale of securities, high long-term interest rates, stoppage of capital construction, fall in prices, unemployment, depression and crisis, will assert itself, and the resultant reduced import requirements and the lower domestic price level will finally ensure equilibrium in international interchanges.

If the internal credit system is not limited by gold or other requirements, there need be no technical limit to the creation of new commodity money, other than such inherent in full employment of all productive forces in the country. The whole process is likely thus to be accentuated in intensity, and when it is recognised that further expansion cannot take place the depressing factor of excess imports will make itself fully felt. The developments above described will inexorably advene, and when stability is re-established it will be on the ruins of an impoverished community and foreign trade will have to be rebuilt from a level likely to be but a fraction of its former one.

Both under a gold standard and under a managed currency these developments may be retarded if the foreign-

owned balances are left voluntarily in the country with excess imports. There is then no pressure to sell these balances against foreign money, and, therefore, no withdrawal of gold or falling exchange as the case may be. If, apart from this negative factor, there happens in addition to be a demand for bank balances in that over-importing country for account of parties abroad in order to benefit by high interest rates quite likely to prevail under the conditions we have assumed, the exchange value of the money in terms of other moneys may even rise for the time being. Domestic capitalists, correctly diagnosing what is happening, would avail themselves of that opportunity of exchanging their domestic securities into bank balances, and the latter for bank balances in some other country not suffering from the same disease. This is what happened in Great Britain during the succession of years of excess imports prior to devaluation of the pound. When, to persistent excess imports finally came inflation through Government deficits, brought about by the ever-growing trade depression ultimately bound to follow in the wake of excess imports, the bomb burst. Everybody wanted to dispose of their bank balances in Great Britain at the same time. Their value fell, the volume of gold available was inadequate, and devaluation became inevitable.

Persistent excess of exports in the long run is scarcely a happier problem. It is true that the immediate effects upon the country having such excess exports appear stimulating. Inasmuch, however, as this semblance of prosperity is achieved in the long run at the cost of the demolition of international interchanges and the ultimate disruption of the domestic economic existence of the countries with persistent excess of imports, it cannot be more than a transitory phase. We have seen the devastating effects wrought by the persistent excess of exports from the U.S.A. which finally led to breakdown throughout the world.

The first result of an excess of exports over imports, visible and invisible, is the accumulation by exporters of bank balances abroad which cannot be exchanged for

domestic bank balances because, in the circumstances we have assumed, there would be no foreign owners of domestic bank balances. Domestic capitalists could, of course, acquire the foreign balances, but this would represent capital movements, already alluded to above and here to be disregarded.

These foreign balances then could either be withdrawn in gold, if the foreign debtor country is in a position to supply it, or they would pass from hand to hand in the over-exporting country, being offered down until the foreign currency had depreciated to a level at which the balances could be withdrawn profitably in the form of goods. In practice, of course, such transactions are indistinguishable from the general mass, but the ultimate outcome is not affected thereby. If gold is received in payment of the claim in respect of excess exports, it will be converted into new bank balances through the machinery described in the First Section of the book, in which the technical working of the financial system was dealt with.

That new money will be cancelled in repayment of loans which the exporters were unable to repay so long as they had not disposed of their foreign balances for a domestic bank balance. Thus there will be no increase in the total volume of commodity money in circulation, but a reduction in bank loans to the level of the reduced volume of goods. The latter will be less than that which gave rise to the distribution of the commodity money in existence, for more goods have left the country than have come in. The relationship then between goods and money is modified in favour of goods. Prices of goods will rise. That in these circumstances exports must decline need not necessarily bring about restoration of equilibrium, since imports may be artificially restricted to the same or to an even greater extent. Internally economic activity would be stimulated into boom by rising prices and by the potentialities of credit expansion latent in growing gold stocks at the Central Bank. The body economic of a country with persistent excess exports is battening upon the emaciated systems of its neighbours whose life-blood is being sucked.

Catastrophe inexorably follows when the limit of credit expansion is reached.

If gold is not available abroad, the foreign balances will be offered down until, at the reduced value of the foreign money, goods can be taken in payment. Meanwhile the immediate effect in the country with excess exports is to alter the relationship between commodity money and goods, and for prices to tend to rise. In contrast, however, with the position when gold was received, the loans of the banking system cannot be reduced, nor is the basis of the credit system widened, as there are no additions to gold stocks. The stimulus to domestic development will not be as powerful in consequence, as credit expansion could not go so far. International interchanges will decrease, because exports will be discouraged by higher domestic prices, imports kept down by tariffs, prohibitions, quotas, etc. Domestic activity will increase, foreign trade will be hamstrung. The havoc wrought in the countries with excess imports we have described above, and a similar crisis is bound ultimately to result in the over-exporting country.

When equilibrium in foreign trade is finally restored, it will take long to overcome the suffering and demoralisation everywhere inflicted. No country can prosper in the long run when others suffer.

Whatever way, then, we examine the problem, lack of equilibrium in current international payments accounts, even if temporarily obscured, must ultimately lead to readjustment on a lower scale, after having taken toll in misery and demoralisation.

Under uncontrolled and unplanned international economic relationships there can, of course, be no assurance of equilibrium.

Notwithstanding the vital importance to the community and to other communities of such equilibrium, the fatal *laissez-faire* attitude still prevails in many countries. In others it has been replaced by the even more pernicious doctrine of self-sufficiency. The former ignored the fact that the interest of the individual in the international economic interchanges, as in other fields, is often incon-

sistent with the true welfare of the community as a whole. It was based, too, on a faulty apprehension of the working of the money mechanism, to which an automaticity was attributed which in reality it possessed only with a great time-lag and at the cost of terrible privation. Representing a revulsion from that passive aloofness, the autarchy doctrine sets up an ideal which ignores the just expectation of the individual that he should benefit to the fullest possible extent, through interchange of goods, by the bounteous resources with which God has equipped His earth. It substitutes the altogether artificial ambition to be independent of one's neighbours. Apart from the insensate waste of the wonderful gifts of God, what a travesty it implies of that relationship between human beings which Our Lord proclaimed to be our common Father's will! What affluence might be enjoyed by the countries of the world if the whole of their productive power were utilised so as to yield the greatest benefit to themselves and others! Then the futility of importing without thought as to how the goods were to be paid for, and without any kind of central responsibility to ensure that more needed goods were imported instead and that exports kept pace with imports, would be clearly apparent. Equally, exports would no longer be regarded as an end in themselves. A community working to its full capacity and enjoying true identity of interest surely could not make its first consideration what goods it could sell elsewhere. It would primarily be interested in establishing what goods it could use and how much of its time would have to be set aside for making such things as would be acceptable to others abroad in exchange for the things the community needed to import from foreign countries. As international economic relations are conducted at present, no matter how patchwork may for a time restore a semblance of prosperity, ultimate breakdown is inevitable as crisis succeeds crisis. No permanent progress is practicable until each country enjoys equilibrium in its external payments accounts, which in turn will depend greatly on internal financial and economic policies.

This does not mean, however, that we should wait with

folded hands until others alter their point of view. There is a vast field for action open to us, provided unity of purpose can be achieved within our borders. Unless we recognise that the problem is not one for self-adjustment, but will have to be tackled with the utmost urgency in all its aspects, the march towards disintegration of human society can only be temporarily arrested, before it inexorably proceeds afresh and with cumulative force. Our proposals for a new order will indicate the lines which each country can follow for itself so that its international economic relationships shall no longer constitute a threat to the stability of the whole economic structure, but shall fit into the planned activities of a community engaged to its fullest capacity in productive work.

Chapter 19

FOREIGN LENDING

Under this heading we propose to consider briefly the various types of migration of capital, mainly from the point of view of their effect upon the money flow and the economic position of the countries involved. The scope of this book does not permit going into details of the various types of operation by which capital is exported, and we shall content ourselves with a rough sketch of generic characteristics.

Capital migrations are distinguished from domestic investment in that the capital assets into which the emigrating capital is converted (foreign bank balances, foreign securities, etc.) are acquired from foreign interests. Consequently payment for the same involves the transfer to foreign ownership of a domestic bank balance or of other assets previously domestically owned. The owners of the emigrating capital need not necessarily have direct dealings with the foreign interests concerned, as the export of capital may be effected through a bank or issuing house. This happens when, in a country, a public or private placing is made of new foreign securities. The capitalists in the "lending" country who subscribe for the new capital merely transfer their bank balances to other parties at home, viz. the issuing or financial houses identified with the business. It is these in turn who act as the purchasers of the foreign investments from the foreign borrowers or enterprisers seeking capital, and they pass on the domestic bank balances collected by them to the foreign interests concerned.

It may be well to point out that purchases of existing foreign securities by domestic investors from existing domestic holders do not represent an international movement of capital. Transactions of that kind are, in every

respect, identical with investment in existing domestic capital assets, with which we have dealt in an earlier chapter.

On the other hand, purchase of domestic securities from foreign owners *would* represent emigration of capital from the country of the purchaser, because it would involve the transfer of a domestic bank balance to foreign ownership in payment of capital assets. In fact it signifies the re-export of capital which had flowed into the country when the domestic securities originally passed into foreign ownership.

Capital migrations are also in a different category from the international payments entailed by current international trade and by the discharge of current international financial obligations. The difference is not outwardly discernible in the mechanism of settlement through the foreign exchanges. It lies in the character of the assets acquired by the owner of the emigrating capital as compared with those acquired when payments are made abroad in connection with current international interchanges. The capitalist transferring his money abroad may retain it in the form of a balance in a foreign banking system, or may acquire securities, land or buildings from foreign interests, take a participation in enterprise abroad, etc., etc. Whatever may be the assets he will hold, they will represent capital to him.

In current international trade, on the other hand, the transferor of money to a foreign country is indebted for current goods purchased, current services (shipping, insurance, etc.), or for current obligations to be met (dividends, interest, etc.). The assets received in exchange—or the extinction of current liabilities achieved—do not represent capital assets.

Capital migrations may assume a variety of forms.

They may, for instance, by their nature be long- or short-term operations. It is not always practicable, at the inception of a transaction, to determine whether it is a long- or a short-term operation. The public issue of a new long-term foreign loan or the private placing of new shares of a foreign enterprise are essentially long-term or semi-

permanent operations, particularly when the foreign securities thus acquired by domestic capitalists are not negotiable in other markets. On the other hand, the acquisition of a bank deposit in a foreign country by a capitalist at home, in order to take advantage of higher interest rates obtainable abroad, is obviously conceived as a short-term export of capital. In between the well defined types such as those mentioned there is a wide range of capital movements indeterminate in regard to period of time. Their duration is likely to be governed by the interpretation which the owners of the exported capital place upon political, economic and financial developments.

In the case of public issues or placings of new foreign securities the capitalists subscribing for the same may not conceive their participation as a long-term investment. Nevertheless the transaction in its entirety is to be so regarded. As explained above, it is in the nature of a collective operation, and it will make no more difference to the international financial relationships created as a result of the issue whether someone else in the lending country subsequently takes the place of the original subscriber than if the latter had changed his name.

International capital movements involving long-term investment, as we shall see, leave a lasting imprint upon the economic relationships between countries. Short-term migrations have in recent times, however, assumed a growing significance through their immense bulk, their synchronised incidence and obstinate persistence. Long-term capital movements cannot be profitably undertaken while political antagonisms, conflicting financial and economic policies and unstable internal social conditions are rampant. These are the very soil, however, in which mass short-term capital migrations flourish. Ever since the War these have been a constantly recurring and gravely disturbing feature of international financial relationships.

Apart from long- and short-term capital movements, we may differentiate between those resulting from the initiative of foreign interests seeking capital and capital export undertaken by domestic capitalists from motives

unconnected with the requirements of the countries to which the capital flows. The former group includes public issues and private placings of new foreign securities in the "lending" country. (For the sake of convenience we shall designate the country of the capitalists supplying the capital as the "lending" country.) To the same category belong financial participations by individual capitalists or by enterprise at home in enterprise abroad, etc., at the instigation of the foreign interests involved.

Amongst capital movements dissociated from the economic requirements of the country of destination we include the acquisition of balances in foreign banking systems, retained as such or invested, as a speculation or as a refuge from risks at home (flight of capital) or for other reasons; the purchase of foreign or domestic securities from owners abroad merely because of attractions they may offer in yield or prospects, or because it is desired to acquire influence in the management or control of the policies of the enterprise concerned, etc., etc.

The above classifications are helpful in diagnosing the character and estimating the probable course and intensity of specific capital movements. The significant feature from the point of view of the money flow and the economic position of the capital-exporting country, however, lies in the disposition made of the domestic bank balance that must be made available as the initial stage in all transactions involving the export of capital. The right to dispose of that balance may have been transferred by domestic capitalists to foreign ownership. In that case we are interested in the utilisation made of it by the foreign interests acquiring it. On the other hand, the balance may first have been exchanged by the domestic capitalist into gold or goods and these exported for the purpose of being converted into a bank balance abroad. Gold and goods are the only two forms in which capital can be physically exported.

According to the disposition made of the domestic bank balance, exports of capital fall under two main groups so far as the lending country is concerned:

1. Linked with export of goods.
2. Divorced from goods.

The first embraces all transactions in which the domestic bank balance, representing the capital to be exported, is utilised in the acquisition of goods in the lending country. Thus, for instance, the public issue made in the lending country of bonds of a foreign enterprise, of which the proceeds are used to buy machinery in the lending country, would fall under this description. So would, for instance, the financial interest taken by an individual capitalist in the lending country in a private partnership abroad engaged in mining, if the latter determined to dispose of the bank balance placed at its disposal by purchase, say, of plant in the lending country to be shipped out to the scene of its operations.

Capital exports, which, so far as the country supplying the capital is concerned, are dissociated from goods, can take place only in two forms :

(*a*) By the export of gold. The domestic capitalist may himself exchange his bank balance for gold or the foreign interest to whom it is transferred may do so, in the open market if there is one, or at the Central Bank if the capital-exporting country is on the gold standard.

(*b*) By countervailing immigration of foreign capital. This arises when the capital exported does not take the form of goods or gold. In that case the foreign transferees of the domestic bank balances, which serve as the vehicle for the capital export, retain the same or employ them in the acquisition of capital assets in the capital-exporting country.

Before examining the effect upon the body economic of each type of disposition of the domestic bank balances representing the capital to be exported, we must be clear as to the character of these balances. If the exporter of capital is an individual the bank balances utilised must constitute past or current surplus income ; if an enterprise, past and

current undivided profit, or working capital. The latter, being part of the capital resources of the enterprise, must in turn have been supplied by individuals out of surplus income or by enterprise out of undivided profit. We may say then that all capital represents past or current income of the individual or undistributed profit of enterprise. What matters from the point of view of the effect of the export of capital upon the money flow is how that money was employed just prior to its transfer to, or utilisation by, the capitalist desiring to export it, and what becomes of it as a sequel to the export.

It may, prior to its destination as a vehicle for the export of capital, have been held as an idle bank balance; it may have been circulating amongst goods and services or amongst capital assets. Any bank balance tendered in payment of assets realised by owners of invested capital who desire to export the proceeds must belong to one of those three categories.

In so far as these balances represent current surplus income of individuals and undivided profits of enterprise they are indispensable to the absorption of current goods and services.

Under our present system, however, we have no means of determining what part of capital exported falls under that definition. In fact, no more than vague estimates are available even of the aggregate of capital exports. We must, therefore, content ourselves with indicating in general terms the effect upon the money flow for each type of capital emigration according to the character of the bank balance utilised. I append a table which gives this analysis in summarised form.

As will be seen, the only kind of international capital movement which does not disturb the money flow amongst goods and services, and may even stimulate it, is capital exported in the form of goods. All other forms of capital emigration are unconstructive and potentially no less harmful than certain forms of domestic investment, with the aggravating feature that the capital exports may directly entail gold exports or distortion of the international value

EFFECT UPON MONEY FLOW OF THE THREE TYPES OF CAPITAL EXPORTS ACCORDING TO THE CHARACTER OF THE MONEY REPRESENTED BY THE BANK BALANCES UTILISED AS A VEHICLE FOR THE EMIGRATION OF CAPITAL

Type of Export of Capital		Character of Money Utilised			
				Bank Balances representing Past Surplus Income and Undivided Profits, previously circulating amongst—	
According to disposition made of domestic bank balances serving as initial stage		Current Surplus Income of the Individual and Current Undivided Profit of Enterprise	Idle Bank Money	Goods and Services	Existing Securities and other Existing Capital Assets
1. Export of goods		Restored to circuit flow amongst goods and services	Stimulating effect upon goods and services	Restored to circuit flow amongst goods and services	Diversion from flow amongst securities with stimulating effect upon goods and services, and depressing effect upon securities, etc.
2. Export of gold		Irrevocably withdrawn from absorption of goods and services. Directly depressing effect upon goods, etc.	No direct change other than cancellation of this idle money	Irrevocably withdrawn from money flow amongst goods and services. Directly depressing effect upon goods, etc.	Irrevocably withdrawn from circulation amongst securities, etc. Directly depressing effect upon securities, etc.
		Corollary: credit restriction with all-round depressing effect			
3. Temporary counter-vailing immigration of foreign capital deliberate or involuntary	(a) Left idle as bank balances in domestic banking system of capital-exporting country	Withheld for the time being from absorption of goods and services with depressing effect upon same	No change	Withheld for time being from absorption of goods and services with depressing effect	Withheld from circulation amongst securities, etc., with depressing effect upon same
	(b) Utilised to buy securities in the capital-exporting country	Do do.	Stimulating effect upon securities	Diverted for time being from flow amongst goods and services	No change

of the money of the country out of which the capital flows.

The issue in a country of a new foreign loan or other foreign financing, the proceeds of which (*i.e.* the domestic bank balances transferred to the foreign borrower or enterprise) are wholly utilised to pay for goods in the country supplying the capital, is in principle immediately beneficial to that country. Of course, such financing presupposes surplus income available for investment, in other words a state of economic development under which not all goods produced within the country and those secured in exchange for goods exported are needed to maintain existence. Foreign financing availed of in goods, in fact, involves the loan of goods or the supply of goods as permanent capital without immediate *quid pro quo*. Clearly, only a community with such a surplus can afford to do this.

In order that operations of this type may be lastingly advantageous, both to the country supplying the capital and to that receiving it, the nature of the goods into which the capital is converted must be appropriate. When these goods are the means of production or development of natural resources in the "borrowing" country and the latter's products are needed by the "lending" country, there is an adequate basis for the financing. One further prior condition requires to be fulfilled if transactions of this kind are to prove remunerative in the long run. The character of the borrower should be fundamentally sound. Character of the people, individual and collective, is, and will ever remain, the ultimate criterion that determines the value of all other assets in a country. Without it, the finest physique of its man-power, the most bounteous resources, the keenest intelligence and ingenuity, can offer little permanent basis for reciprocally satisfactory human relationships of any kind.

With these fundamental requirements satisfied there remains the imperative need for the provision of means whereby the annual current obligations resulting from the capital operation (interest, dividends, amortisation) can be discharged by the "borrowing" country. Under our

present order, with its haphazard and chaotic international economic intercourse, there is no conscious endeavour towards that end. Although in the preceding chapter I have already referred briefly to the mechanism whereby such annual payments are effected, a few further observations on the subject may be helpful.

If the means of production supplied to the " borrowing " country on credit, or as permanent capital, achieve the object of increasing the productivity of that country, there should be an additional volume of goods available for export. Their sale will give the exporters in the " borrowing " country command of bank balances abroad. These they sell to the interests in their own country which have borrowed abroad or are working with capital supplied from abroad. We shall, for the sake of brevity, refer to those parties as " the borrowers ". In return the exporters receive from the borrowers a domestic bank balance. That balance represents the interest on the foreign debt set aside by the borrower, or part of his profit due to the foreign capitalists who supplied capital. In the borrowing country then the circuit flow of money is complete by the restoration to the circuit of these funds previously retained by the borrowers. Increased current domestic turnover of labour and goods has resulted from the loan made in the form of the means of production. In the " lending " country the bank balances acquired by the " borrower " will be transferred to the holders of the foreign securities (bonds, debentures, shares) or to the partner in non-joint-stock foreign enterprise. To the recipients in the " lending " country they constitute income which, if re-spent on goods and services, remains part of the commodity flow of money. In the " lending " country the turnover of money too is increased by the additional imports, which should enhance the standard of comfort and well-being of the community.

Failing additional exports from the country of the borrowers, disequilibrium in its current international balance of payment arises, with fateful consequences which we have sketched in the preceding chapter. If the debtor country is on the gold standard its entire economic life will be forced

down to a lower level by loss of gold; if it has a managed currency the results are ultimately equally disturbing.

The inevitable consequence of inability of the debtor countries to sell their goods abroad in sufficient volume in excess of their imports is default. To the extent that this leads to permanent scaling down of annual obligations, it involves the lapsing of an annual claim to goods previously enjoyed by the "lending" country, with corresponding reduction in the average standard of living. Moreover, to the owners of the capital assets representing the money lent or capital supplied, the loss of current income is accompanied by depreciation in the money value of the asset. This depreciation is in itself of no direct consequence so long as the asset is held, but if the owner desired to sell or borrow against it, in order to utilise the proceeds in enterprise, his potential capacity in that direction would be impaired.

We now turn to capital movements divorced from goods so far as the country supplying the capital is concerned. These are wholly prejudicial to the welfare of the community, and if their destructive effect were but appreciated it is certain that our attitude towards them would be different from the present *laissez-faire*.

It is often suggested in regard to foreign financing that it is not vital that the capital lent, or supplied, to foreign interests should be spent on goods in the "lending" country, so long as it is spent on goods somewhere. The increased prosperity in the countries which supply the goods, so it is argued, must ultimately be reflected in increased imports from the "lending" country. This facile notion is fully exploded by our own experience. Though it may be admitted that, taking a broad view, such financing in degree of perniciousness ranks behind capital movements completely divorced from goods, since at least it diffuses economic activity somewhere, there is, so far as the lending country is concerned, no material difference.

Capital movements unconnected with the economic interests of the capital-exporting country may be engendered by a variety of motives, amongst which speculation, tax

evasion and political fears are the most conspicuous. The effect, in every instance, is to bring about the offering of balances in the banking system of the country from which capital flows away, without corresponding demand. Inversely, demand without corresponding offer arises for bank balances in the country to which the capital emigrates

Once the owners of the capital, desirous of exporting their money, have acquiredt he foreign balances, the latter will either be immobilised as idle deposits or will be utilised to buy securities, and are likely to pass from hand to hand amongst owners of existing capital assets in the foreign country. The domestic bank balances ceded by the exporters of capital will have been transferred to foreign ownership and will not be available for the circuit flow amongst goods and services. To the extent that they previously had been so circulating the effect upon the turnover of goods is disruptive. The balances may be cancelled altogether if they are converted into gold, assuming this is obtainable at the Central Bank, or they would be offered down with progressive depreciation of the exchange value of the money of the capital-exporting country in terms of the money of other countries. The result in either case is destruction of the domestic economic interchanges of goods and services, immediately so if gold is exported in appreciable volume, more gradually when gold is not available. In the latter case unwilling foreign holders of domestic balances offer them down until finally it becomes profitable for foreign importers to acquire them and convert them into goods for import into their country, thus restoring the money to the commodity flow.

As compared with the disequilibrium in the balance of international payments resulting from excess import of goods, these capital migrations present the aggravating feature that no goods are created anywhere in connection with these transactions. It is true that indirectly, in the country to which the capital is transferred, economic activity will be artificially stimulated through a decline in the long-term interest rate, particularly if gold flows into

that country, but upon the ruins of the economic order of other countries no lasting prosperity can be based.

If capital exports from a country happen to coincide with capital imports into that country from abroad, no effect is, for the time being, produced upon the exchange value of the money of the capital-exporting country in terms of the moneys of other countries. The offer of domestic bank balances in that contingency would be offset by countervailing demand by foreign capitalists. Thus the damaging effects of the export of capital are temporarily suspended, though not eliminated. In the countries concerned, bank balances will have passed into the hands of foreign owners having no permanent stake in the welfare of the country which, for the time being, they have selected as the domicile of their capital. In so far as those balances were previously circulating amongst goods, they are now withheld from the commodity flow. Moreover the synchronisation of the capital movements in opposite directions having been purely accidental, there is no assurance that similar coincidence will recur in the repatriation. Hence, if the capitalists in one of the countries, from which capital had previously been exported, were to decide to dispose of their assets abroad and re-acquire bank balances in their own country, the withdrawal of this capital would expose the country losing it to all the consequences entailed by export of capital unconnected with goods, as described above.

Summarising, then, international capital movements can be achieved without disruption of the domestic circuit flow of money amongst goods and services only when directly productive of export of goods in corresponding amount from the capital-exporting country, and when the parties to whom the capital is supplied are solvent and of undoubted integrity.

Any other form of capital migration is injurious to the community.

Fantastic though it may seem in the light of the devastation wrought, the individual, under our present order, is free, in his unfettered discretion, to export capital. It is true that certain forms of capital export, including in fact the only

desirable one, are barred in this country for the time being, but this leaves full scope to almost every harmful activity of this type " through the backdoor ".

Under a new order, the entire problem must be envisaged from an altogether different angle. The action of the individual in pursuit of purely selfish objects in this, as in every other sphere, must be made subservient to the interests of the community as a whole.

CHAPTER 20

FOREIGN EXCHANGE

THE mechanism through which all international payments are settled is the foreign exchange market. The transactions which give rise to such payments have been considered in the two preceding chapters. They represent either foreign trade, visible and invisible, including fulfilment of current international obligations, or international capital migrations. A foreign exchange transaction consists in the purchase or sale of a balance in the banking system of a foreign country and giving, or taking, in exchange a bank balance at home or in another foreign country. Dealers in foreign exchange, therefore, must have banking accounts in all the principal countries. Hence, as a business, trading in foreign exchange is confined to banks and bankers, with whom all demand for and offer of balances abroad are centred. In foreign exchange transactions between banks and bankers themselves, the services of foreign exchange brokers are employed as intermediaries.

As in commodities, it is mostly possible to deal in foreign exchange for future delivery. Operations of this class do not occasion actual payments—that is, an exchange of bank balances at home and abroad—until maturity of the contract. However, meanwhile they frequently engender "spot" transactions, and the relationship between the rate for "spot" and for forward delivery is significant and instructive in many respects. We comment further on this class of foreign exchange transactions on a subsequent page in this chapter.

Business between importers and exporters of goods and services in different countries is frequently done in a money which is not that of either of the countries concerned. Thus between countries in South America, for instance, transactions, in many instances, are effected in pounds or

dollars, because there is a large market for both these moneys and they enjoy, in consequence, a greater measure of stability. The resultant foreign exchange transactions can have no effect upon supply and demand so far as the money is concerned in which the transactions are to be settled, for they obviously involve equal demand for and offer of balances in the banking system of the country whose money is selected for the purpose. If a Brazilian exporter sells cocoa to an Argentine importer and payment in pounds is agreed upon, the Argentine importer will wish to buy a balance in London, offering an Argentine peso balance in exchange. The Brazilian importer will want to dispose of that balance in London in order to obtain one in his own country in exchange. Thus there is an offer of Argentine pesos and a demand for Brazilian milreis, just as if the transaction had been settled direct in one or other of these currencies. If we assume equilibrated current international payment accounts for each country, the demand for and supply of balances in the banking system of each country must be equivalent. There may be more Argentine peso balances wanted in London than there are on offer, but then they are bound to be for sale elsewhere, and as the excess demand in London would tend to increase the value of peso balances there, sellers in other countries would be attracted to meet the shortage in London. It is one of the important points in the technique of foreign exchange to know where the best markets for different moneys are and whether in such markets buyers or sellers normally predominate. Knowledge of the nature and direction of trade between the various countries of the world and of the prevailing customs in regard to the moneys in which transactions between them are most often expressed is indispensable for that purpose.

Rates of foreign exchange express the price relationship between units of money of one country and those of another. They fluctuate constantly according to whether, for the moment, the offer of bank balances in any foreign country or demand has the upper hand in the markets. Through the kaleidoscope of fleeting changes and short-

term movements, however, definite trends are at times discernible over long periods. These reflect persistent predominance of supply or demand. Their immediate cause lies in disequilibrium in the current balance of payments (foreign trade, visible and invisible, and current international obligations) or in capital migrations. Their deeper origin must be sought in divergence between the financial and economic policies pursued or between the political conditions prevailing in the countries concerned. It is into these longer trends in the foreign exchanges that we shall briefly probe.

It is sometimes assumed that movements in foreign exchange rates reflect more or less faithfully the divergent variations in the relationship between money and goods—*i.e.* in the price levels—of the countries concerned. That would be true only under conditions—not now obtaining anywhere—in which no other factors intervened which obscured the effects of those divergences upon the external economic activities of countries. In such conditions exports would be hampered and imports attracted in the country in which the price level had risen more, or fallen less, than elsewhere or had remained stable while it fell in other countries. The money of that country in terms of the moneys of other countries would become worth less in consequence of its balance of international payments having become adverse. In practice, however, artificial restrictions upon imports, stimulation of exports and capital migrations vitiate the basis of the assumption above mentioned.

We may distinguish three kinds of foreign exchange relationship : firstly, between countries on an international gold standard basis ; secondly, between countries on gold, on the one hand, and countries not on gold, on the other ; and thirdly, between non-gold countries.

Countries having an international gold standard are those in which there is free exchangeability of imported gold for the money of the country at a rate fixed by law, and where gold required for export can be freely obtained from the Central Bank against money likewise at a fixed rate.

This is the limited form of gold standard which replaced the full gold standard—now a distant memory—under which gold coins were a circulating medium and free interchangeability between money and gold extended to domestic circulation. Non-gold countries are those in which there is no fixed rate for the interchange of gold and money.

The working of the foreign exchanges between gold countries is just now not of great practical importance, as there are none at present. Even in the United States restrictions upon export of gold are in force. Suffice it for the moment to say that the rates of exchange between gold countries, that is, the value of the money of each in terms of the moneys of the other countries, are governed by the relationship between the fixed money prices of gold in each country. Whilst to the resident in such countries, under the restricted form of gold standard, money and gold are not synonymous so far as domestic business is concerned since he will be unable to exchange money for gold, to the foreign owner of balances in gold countries they are, as well as to the domestic debtor or capitalist requiring to remit money abroad. So far then as international transactions are concerned, the moneys of all gold countries become an international money. Clearly if these transactions, from whatever cause, involve persistent demand for the money of one country and persistent offer of that of others, the flow of gold will be all one way. As gold serves in many countries also as a basis of credit, the flow must be arrested long before the stock is exhausted. When gold is no longer available to satisfy demand for bank balances abroad, then the latter will be bid for against offer of bank balances at home, *i.e.* the exchange will depreciate in terms of gold, which is equivalent to saying that it depreciates in terms of the moneys of countries in which the fixed relationship between money and gold still exists.

It has been clearly demonstrated by financial events since the War that the relationship fixed by law for interchange between gold and money within a country, *i.e.* its rate of exchange in terms of the moneys of other gold

countries, can have no permanence if conditions arise which produce discrepancy between the price level in that country and the gold equivalent of the price level elsewhere so wide and insuperable as to defy attempts at correction. Since imports would be bound to be attracted to the country with the relative increase in the price level, and exports would be hampered, the first line of defence usually consists in restrictions upon imports. However, the scope for such measures is limited. Moreover, capital is likely to flow out of that country in the circumstances we have assumed, and this would add to the demand for bank balances abroad against offer of its own money. As domestic conditions deteriorated and the utter impracticability of bridging the gap between the relative price levels was more forcibly brought home, political unrest, inseparable from such developments, would lift its head, turning emigration of capital into flight, with ultimate breakdown of the fixed foreign exchange relationship with the moneys of other gold countries, as described above.

Two sets of causes may be responsible for the generation of grave and persistent discrepancy in relative price levels :

1. Domestic financial policies pursued over a prolonged period leading to a fundamental change in the relationship between money and goods, *i.e.* in the domestic price level (for instance, credit inflation as a result of war).
2. Unilateral action modifying the pre-existing fixed relationship between gold and money, in the sense of increasing or decreasing the money price of gold.

When policies of the type referred to under (1), persistently pursued, have created an untenable position for the country concerned, it may seek to escape from the consequences by raising the fixed price legally payable in its money for a given quantity of gold.

From the international point of view, increase of the money price of gold in a country without corresponding change in the price of gold elsewhere means that less money of other countries will be needed to buy the money of that

country. Hence the same quantity of goods can be bought there, at least in the first stages, with less foreign money.

In turn, however, such action, if not proportioned to the price levels of other gold countries, may force upon these latter, sooner or later, similar uncorrelated upward revision of the legal money price of gold. This is, in epitome, what has been happening at intervals ever since the end of the War.

Isolated reduction in the money price of gold on the part of a gold country is in a different category. An outstanding instance of this self-sacrificial course is afforded by our return to the gold standard in 1925. It involved the fixing of a money price for gold below the pre-existing market level. The inevitable consequence to the country which has thus increased the gold equivalent of its money must be to raise its price level in terms of the moneys of other gold countries and—*ceteris paribus*—in the moneys of non-gold countries as well. Its competitive position in international trade is adversely affected. In domestic economic relationships the burden of debtors is increased, for goods must decline in terms of the money arbitrarily made more valuable. The dislocation of its external trade is intensified by depression at home. How the paralysing effects of that policy gradually attack every function of the body economic we learned to our cost in the period which followed the reintroduction of the gold standard. Not until the emaciated wreck was nigh exhaustion and monetary policy reversed was the relentless progress of disintegration arrested.

The ends to be served must be very high indeed that would justify exposing the commonwealth to the ravages entailed by one-sided action on the lines we followed in 1925. Looking back now dispassionately upon what was done, there will be few who will maintain that the prestige associated with " a pound that could look the dollar in the face "—a dollar which itself subsequently came to have a very sick look about it—could compensate for the sacrifice in human suffering which it entailed. I further believe that there is nothing in the conduct of our monetary policy at

present which would warrant the faith that the country would not again be placed before a similar ordeal. It behoves all who can interpret the implications of the management of our money to continue to exercise unrelenting vigilance.

We now turn to the foreign exchange relationship between a gold country and a non-gold country. Its long-term trend—assuming, of course, that there is no exchange control—must be in harmony with that of the price of gold in the non-gold country. Externally the money of a gold country represents a fixed quantity of gold. That same fixed quantity of gold will have a variable value in the money of the non-gold country. Hence the rate of exchange of the gold country expressed in terms of the money of the non-gold country will rise when gold rises in price in the non-gold country, and will depreciate when gold falls, and *vice versa.* This need not necessarily be true of minute daily fluctuations, but the movement of the two must correspond when there is a definite trend.

To the long-term trends in the exchange between the gold country and the non-gold country the same general principles apply as to the exchange between gold countries. Its level cannot be maintained approximately stable if conditions arise which produce more or less permanent discrepancy—as compared with pre-existing conditions—between the price level of goods in the gold country and the gold equivalent of the price level in the non-gold country.

If, in the non-gold country, domestic inflation occurred and was likely to continue, for instance, through budget deficits, money prices of goods would rise there, including gold. All other things being equal, that means that the money of the gold country too, being internationally equal to a given quantity of gold, would rise in terms of the money of the non-gold country. The external value of the money of the non-gold country would be far more sensitive to the factors influencing the relationship between its money and goods than would be the case with the money of gold countries expressed in terms of the money of other

gold countries. As we have seen, there are limits beyond which the exchange rates between gold countries will not reflect persistent discrepancies in the trend of price levels, at least so long as pre-existing legal money equivalents for gold continue in force. Inasmuch as there is no such anchor in the case of the money of the non-gold country, discrepancies in demand and supply of balances in its banking system in exchange for balances in other banking systems will not be rectified automatically.

If, in the gold country, policies were pursued which caused persistent deterioration of the value of its money in terms of goods as compared with the non-gold country, the money of the latter in terms of the gold country's money would appreciate, and thus a corrective influence be introduced which would tend to restore the previous relationship between the price levels of the two countries. However, so long as there are other gold countries, this would mean a similar appreciation of the money of the non-gold country in terms of the moneys of those other gold countries. Hence the non-gold country would be placed at a disadvantage in its interchanges of goods with all gold countries. Of course it is to be assumed that the rising price trend in one of the gold countries would in time be counteracted by the outflow of gold to the other gold countries. We know, however, that discrepancies in price trend may continue for long periods as between gold countries.

The remedy of the non-gold country would lie in the control of the market price of gold within its own borders, by which it would prevent any undue appreciation of the external value of its money.

As between countries which are not on an international gold standard, long-term trends in the foreign exchanges are immune from the type of unilateral action in regard to the price of gold to which foreign exchange relationships with gold countries are exposed. Thus the sudden creation of insurmountable barriers between the relative price levels, by distortion of the value of their moneys in terms of each other, is not to be feared in the case of non-gold countries. Any divergence in financial and economic policies would

bear directly upon the balance of trade and upon capital movements. The rates of exchange, if left uncontrolled, would reflect these factors, since the exchanges would not be anchored to one specific commodity: gold. In practice, however, countries with managed currencies whose conduct of financial, economic or political affairs cease to inspire confidence, have been forced to adopt ever-growing restrictions upon their international trade and upon capital movements. A managed currency, combined with freedom from detailed exchange control, has so far proved to be practicable and desirable only where complete confidence in the sphere of domestic and international policies reigns.

So far from a managed currency, in that case, being a blind whereby the true reactions of international and domestic developments are obscured, it is in fact a far more sensitive and infinitely more humane indicator to those in control of the management than the old gold standard ever was. It may be contended that the secrecy which, of necessity, surrounds the operations of management deprives the business community of valuable data to judge the course of economic international interchanges. This drawback, however, is amply outweighed by the freedom from the disturbance of the domestic credit structure to which otherwise the body economic would be exposed under our present system of uncontrolled international trade and capital movements.

The trend of relative price levels as between non-gold countries is by no means the only element that determines the course of the foreign exchanges. Discrepancies in that trend may be counteracted and fail to be reflected in the exchanges by artificial interference through tariffs, quotas, subsidies, etc. The whole character of the foreign trade, the resources, the domestic and international political ambit, the outlook and temperament of the people, etc., all have a bearing upon the problem. Where the exports, for instance, consist in the main of raw materials, necessities and coveted specialities, and only in a minor degree of goods subject to intensive world competition, the international trade of such a country will be largely immune from

the effects of a rising trend in its domestic price level. Even if that rise had been brought about by recurrent Government deficits, confidence in the stability of the political outlook, in the potency of the country's natural resources and in the determination of Government and people to bring about early restoration of budgetary equilibrium will, in the circumstances described, largely neutralise the reactions to be anticipated under less favourable conditions. Flight of capital will not ensue, and the foreign exchanges of that country may remain stable in spite of the adverse features.

On the other hand, if the country with the disproportionately rising trend in its price level had been one the composition of whose foreign trade was highly vulnerable to price influences and to increased cost of imports, whose natural resources were few, and whose international political position, through propinquity to danger spots and dependence upon food supplies, was an exposed one, then, even if its Budget was balanced, we might expect that capital would tend to emigrate and that the international value of its money in terms of other moneys would depreciate.

As to capital movements and speculative foreign exchange operations which, as we have seen in previous chapters, exercise a potent influence upon the foreign exchanges and upon the entire body economic, the data available are hopelessly inadequate. It is astonishing and regrettable that in this country, with its long traditional leadership in financial affairs, estimates concerning foreign-owned bank balances and short-term money should have to be based upon mere guesswork, whereas particulars concerning foreign-owned long-term investments are totally lacking. Nor is any precise information obtainable concerning imports of gold for hoarding purposes. Thus we are dependent upon an examination of the other items in the balance of international payments in the light of the trend of the foreign exchanges, for some guidance as to capital movements. Even so, compensatory cross movements of capital cannot in this way be detected at all. Neither is there any direct clue to the magnitude of the

movements, or to the country of origin and destination of such capital.

We shall conclude with a few comments on speculation in foreign exchanges and on transactions in so-called "forward" exchange. Exchange speculations for a rise can be carried out in two ways, viz. a foreign bank balance can be acquired for prompt delivery ("spot") or for future delivery. The former, in fact, is a migration of capital inasmuch as a domestic bank balance passes into foreign ownership or gold is exported.

Purely speculative purchases of foreign exchange are mostly carried out through the "forward" exchanges, and in that case involve no export of capital. In this way no capital need be locked up, as, if anything, only a marginal deposit is required by the banks who carry out the exchange transactions for account of the speculator.

Speculations for a fall cannot normally take the form of a sale of foreign balances for "spot" delivery. Speculations of that type involve the selling of a foreign bank balance which the speculator does not possess, in the hope of repurchasing it later at a profit. As the average speculator is not in a position to borrow bank money abroad, he must carry out the transaction by the sale of the foreign bank balance for future (or "forward") delivery.

Forward exchange transactions are, however, by no means confined to speculation. Amounts payable or receivable abroad in foreign money as a result of current international obligations are constantly covered against the risk of fluctuation by the conclusion of a "forward" exchange contract. Purchases of forward foreign exchange impose upon the purchaser of the foreign bank balance the obligation to provide its equivalent in a domestic bank balance on the date stipulated and at the rate fixed in the contract. *Vice versa*, the seller of the foreign bank balance undertakes to have it transferred on that date in the books of the foreign bank to the buyer's order, receiving in exchange the domestic bank balance with which the buyer pays the seller.

If we eliminate all capital migrations not effected in the form of goods and all speculation in forward exchanges, and if we assume equilibrium in the balance of current international payments of a country, then the aggregate of demand for " spot " and " forward " balances in that country will equal the aggregate of supply. If there is an excess of demand for " forward " exchange of that country, there must be an excess of supply of " spot ", and *vice versa.*

The forward exchange rate will be either dearer than spot or cheaper, according to whether demand exceeds supply of balances for forward delivery, or *vice versa.*

In normal conditions of stability in the economic, political and financial sphere (unknown since the War) the limits to which such passing fluctuations in the spread between the spot and forward rates of exchange between countries with highly developed banking systems could extend, were largely determined by differences in short-term interest rates in those countries. If the three months' forward rate of exchange for the money of a country, in terms of the money of another, was dearer than the spot rate, it might be possible, by purchasing a " spot " balance in that country and reselling it for delivery three months hence, to make a profit which, added to the interest that would be receivable on the foreign balance during that period, might exceed the return obtainable on a domestic balance invested in three months' bills of exchange or left on deposit. If the difference in interest rates was substantial, it might be possible to employ capital temporarily abroad in this fashion, even if no premium on the forward exchange was obtainable or if it stood at a discount. Such temporary migrations of capital for strictly limited and definite periods and with the rate fixed at which repatriation was to take place, would compensate the temporary excess demand or absorb temporary excess supply of balances in the principal trading countries occasioned by the incidence of the unequal distribution, as between spot and forward exchange, of the transactions resulting from current interchange of goods and services, and from the fulfilment of current international obligations.

Under conditions of instability in every sense, such as we have been experiencing for many years past, the volume of capital available for short-term migration for the sole purpose of profiting by opportunities of earning interest is overshadowed by far by speculative transactions in forward exchange. The spread between spot and forward rates has lost its anchor. Temporary inequality of distribution between spot and forward transactions arising out of current economic interchanges is altogether dwarfed into insignificance. Disequilibrium in the balance of current international payments and speculative transactions in forward exchanges are now the dominating factors in the determination of the relationship between the spot and forward rates. Perhaps general indications given in the schedule on page 211 may serve as a guide to the interpretation of the spread.

The mechanism of the foreign exchanges as a means of settlement of transactions involving international payments is as smooth functioning an organisation as human ingenuity could devise. Efficiently and expeditiously it meets —where left to operate untrammelled—the requirements of an economic intercourse world-wide in scope and covering every conceivable type of international business.

It is, however, a fundamental prerequisite for stability that the items passing through the machinery of the foreign exchanges shall, in the aggregate of the amounts receivable from and payable abroad, be in equilibrium for each country over reasonable periods of, say, a year at a time.

This condition is persistently and almost universally violated under our present order, in the absence of sustained and comprehensive planning in the sphere of international economic and financial relationships, both as regards current trade and capital movements.

The penalty, as we have seen in the preceding two chapters, is the breakdown of the very economic existence of countries with persistent deficiency in their international payment accounts. Tampering with the free functioning of the mechanism of the exchanges, invariably resorted to in such circumstances, though it may be the only way to prevent aggravation of the evil, cannot remedy its causes.

Nature of Dealings in Forward Exchanges	(*a*) Between Two Countries having approximately Equal Level of Short-term Interest Rates	(*b*) Between Two Countries with a Substantial Difference in Short-term Interest Rates
Under normal conditions, in the absence of speculative operations and assuming equilibrium in the current balance of international payments	Forward rate moves closely either side of spot rate	In the country where interest rates were higher the forward rate for the money of the other country would be dearer than the spot rate. *Vice versa*, in the country where money was cheaper the forward rate for the money of the dearer country would be lower than spot.
If balance of international payments of one of the countries not in equilibrium	Forward rate for money of country with excess of exports will be at a premium over spot. Forward rate for money of country with excess imports will be at a discount	Forward rate for money of country with dearer money, if it has excess *exports*, will tend to equal spot rate instead of being lower. If it has excess *imports*, forward rate for its money will tend lower than interest difference would justify. If country with cheaper money has excess *exports*, forward rate for its money will tend to be more above spot than difference in interest rates would account for. If country with cheaper money has excess *imports*, forward rate for its money would tend towards the spot rate instead of being dearer.
If there is speculative purchase of forward exchange of countries with excess exports and speculative sale of forward exchange of countries with excess imports	Forward rate for money of country which speculators buy will be at a premium over spot, as against money of country with excess imports. *Vice versa*, forward rate of money of country which speculators sell will be at a discount against spot rate in terms of money of country with excess exports. As between two countries with excess exports and two countries with excess imports, the relationship between spot and forward rates will depend upon extent of their surplus or deficit in balance of payments and extent of speculative purchases or sales of forward exchange in the case of each	Differences in interest rates would no longer exercise any influence. In fact, if in a country whose money was being heavily sold forward by speculators the interest rate were raised to a high level, it would be interpreted as a panic measure and it would stimulate the tendency of speculators to sell its exchange for forward delivery. The development of spread between spot and forward exchange will be as indicated in column for countries with equal interest rates.

We shackle the machinery because it fails to correct the faults in the materials fed to it, when it is designed merely to transform them !

When once the vital necessity of maintaining the two sides of the international payments account permanently in balance is recognised, any country can take the measures required without waiting for others to give a lead or act simultaneously. Nevertheless, in order that such equilibrium may be achieved at the highest level consistent with the productive capacity of the country, utilised to the full and in directions most expedient and profitable in its interests, the co-operation of other countries is indispensable. No initiative in that sense is, however, likely to be ignored in view of the advantages to all that are bound to accrue from efforts aiming at expansion of international economic relations on such lines.

The course to be followed for the accomplishment of this object will be outlined in the proposals for a new order submitted in the next and concluding section.

SECTION III

TOWARDS A NEW ORDER

"Wisdom is the fine art of committing à particular folly but once."
(From *Quaker Calendar*)

Chapter 21

OBJECTIVES OF THE NEW ORDER

A GLANCE around us in the world will convince us that the old order is doomed. The manner of its disappearance varies according to the state of civilisation, the traditions and the character of the people. The degree of barbarity which marks the change-over in so many lands is a ghastly reminder of the depth of depravation in which mankind is still engulfed, and the distance that separates us from the image of Him that made us all. May God grant that His Light may penetrate into those dark recesses of the human soul that harbour hatreds and evil passions, and by its brightness and serenity expel the powers of darkness. We can only feel deeply grateful to Him for all those in this world to whom, in His infinite goodness and mercy, He has given willingness to be His torch-bearers and grace to reflect His Light.

That not all revolution is accomplished by force is evidenced by the developments in the two remaining great democracies outside the British Commonwealth, the United States and France. Revolutionary changes are being carried out there for all that there is no departure from constitutional procedure.

In the United States alone, amongst all the nations, the features of money economics responsible for the periodic disturbances that characterise the existing economic order appear to have been adequately recognised by those in authority. It has not escaped them that, even in times of so-called prosperity, our money economics, as at present conducted, have failed everywhere to provide continuous employment for the available productive forces at their highest capacity, with a commensurately high standard of comfort for the community as a whole.

Alas, in the United States the division of authority

between Federal and State Government and the severe limitation upon the powers of the elected representatives of the people through the Supreme Court's prerogative of passing upon the constitutionality of acts of Congress, militate against effective application of the full comprehensive range of indispensable reforms. Though this will not render useless such measures as become operative in these circumstances, it will reduce them to the level of patchwork that can, at best, ensure a longer lease of life for the upward swing in the economic trend without being able to ward off ultimate collapse.

The problem of the recurrent trade depression can be conquered only by concentrated mass attack of a coherent body of corrective measures, simultaneously launched against the centres in which the menace to ordered society lies concealed: the financial system; the disposition of surplus income; the lack of control over the nature of transactions involving international payments coupled with failure to ensure their equilibrium; and unbalanced production.

In our survey dealing with the technical characteristics of the financial mechanism, with certain aspects of the enjoyment of surplus income by individuals and of the retention of undivided profits by enterprise, and with the transactions to which international financial relationships give rise, we have drawn attention to the features in each of these spheres which are at the root of the economic plight of the world and of the deplorable conditions under which so many of our fellow-beings are forced to live.

We shall briefly summarise these features here so that we may gain a clear conception of the reforms to which a New Order must address itself.

Under our present system the entire credit structure, as we have seen, is ultimately determined by the amount of gold held at the Bank of England. Since the fiduciary issue of notes is fixed by law, there can be no permanent increase of consequence in the notes held by the Bank of England without change in the volume of gold held. Normally this would entail import of gold, but at present that change

could be effected at any time by a revaluation of existing gold holdings at market price. So long, however, as this is not done and additions of consequence to the gold stock resulting from flight of capital from other countries are counteracted by a lowering of the volume of the fiduciary note issue, the Bank of England's restrictive influence upon expansion of credit is maintained in full effect. It is impossible in these circumstances for the note holding of the Bank of England to increase materially. In turn, the proportion of that note holding to the liabilities of the Bank of England—its so-called deposits—is the criterion for its credit policy. There is a level below which that proportion is not likely to be permitted to fall. Now the liabilities of the Bank of England include as the principal item the reserves of the banking system. When the Bank of England determines that it cannot expand its liabilities further, this means that the deposits of the banking system (the deposit banks) at the Bank of England cannot increase. These " bankers' deposits " at the Bank of England, as we know, form part (about half) of the reserves of the banking system and constitute the flexible portion dominated by the credit policy of the Bank of England. The other half consists of currency and specie—so-called till money—and is not flexible. Generally the reserves of the banking system (the deposit banks) are no more than adequate in proportion to its liabilities. These latter consist of the deposits owned by the public at large. Thus when the deposits of the banking system at the Bank of England cannot be further expanded, the banking system in turn cannot permit its liabilities to grow further. Here, then, we have the link between gold and the volume of credit, *i.e.* bank deposits or bank money. Any increased demand for credit, however economically desirable its objects, can be satisfied, from that point on, only by sale of securities by the banking system. The very virus that saps, and ultimately destroys, economic activity is thus injected into the body economic just when an upward trend promises to assert itself with increasing vigour. How the disruption of the interchange of goods and services, via rising cost of long-term capital, is finally encompassed has

been fully analysed in earlier chapters. Here we merely set out the sequence of developments.

The absence of any correlation between the note issue and the type of asset which the productive elements in the country are in a position to give as security for loans to the banking system, divorces the credit created by the Bank of England—based as it is upon that note issue—from the economic activities of the country. Furthermore, whilst the possession of securities conventionally entitles the banking system to Bank of England credit, the productive assets pledged to the banking system by its customers to secure loans do not. This is bound to warp the entire banking outlook in regard to the relative merits as collateral for loans of the two types of security.

The ruthless tyranny of gold as the sole ultimate basis for expansion of credit would be strikingly brought home if the banking system were confronted with the necessity for refusing genuine trade loans. This would be inevitable were it not that the banking system is always a holder of a large volume of Government securities. These serve as a cushion to absorb the first shock of credit demand in excess of credit expanding capacity. It is not conceivable that the community would tolerate any refusal to grant desirable self-liquidating credit accommodation. Yet as things are, it tolerates a state of affairs which ultimately leads to the same disastrous result by a devious route. The true position is obscured by the sale of securities by the banking system. Instead of demands for credit having to be refused outright, they are slowly but inexorably stifled by the poison which the gradual forcing up of the long-term rate of interest subtly spreads through the entire body economic.

The sway of gold does not end, however, with its control over domestic credit expansion.

Through international economic relationships too it has the material destinies of countries in its grip. The fatal conception that unfettered freedom of the individual in the conduct of his economic affairs is an ideal capable of being reconciled with the true welfare of the community is still rampant. Uncontrolled capital migration divorced

from the international movement of goods and unbalanced international trade accounts are countenanced with equanimity. This attitude of unconcern is encouraged by the fact that the dismal sequel to those features is sometimes long deferred, frequently concealed from notice by mutually compensatory capital movements, and when finally inexorably revealed, not always readily traceable to its origin through the manifold unrecognised domestic repercussions set up in the interim. The process by which disequilibrium in international payments account disrupts the interchange of goods and services has been fully explained in the final chapters of the previous section.

Without hesitation it may be said that the terrible devastation we see around us in the world is primarily due to the abject failure of statesmen to appreciate the vital, the paramount need for balanced external payment accounts. Had this been recognised in its full significance, the insane capital transferences imposed by the Peace Treaty would have been rejected as an inspiration of Satan. In fact, they were none else, since that policy was the expression of a desire for vengeance, a usurpation of God's prerogative.

In the settlement of major and persistent discrepancies in the international balance of payments the only alternatives are gold shipments or disturbance of the stability of the foreign exchanges. As we have seen in previous chapters, there is little to choose between them. Disruption of domestic interchange of goods and services follows in the wake of both, but where gold is the only means of settlement the adjustments involved operate with a crushing ruthlessness of which, alas, we have had ample experience during the period between our return to an international gold standard and its renewed abandonment.

In the domain of man's dealings with what he is wont to regard as " his money " the same absolute discretion is enjoyed by the individual as we have found to reign in the sphere of transactions involving international payments, with the same distressing result. As we have seen in earlier

chapters, certain forms of the disposition of surplus income of the individual and of undivided profit of enterprise involve the withdrawal of "commodity" money from absorption of goods and services, although the whole of such commodity money is indispensable if the means to pay for all current goods and services are to be available. The menace to the body economic inherent in this feature invariably becomes acute at the very juncture when an uninterrupted circuit flow of money is more than ever essential. In fact, money economics are unconsciously engaged in a continuous struggle to correct the nefarious effects upon the body economic of excess of withdrawals from the flow of current commodity money over accretions. The correctives applied under our present order are bank policy and enforced readjustments in output of goods, which for a time cause accretions to the commodity flow to predominate, but action is not taken until the toll of privation and demoralisation becomes so appalling that society is brought to the verge of breakdown.

Finally there is another powerful force destructive of ordered economic existence. Under our present system production is at the mercy of unbridled competition—one more of the much vaunted prerogatives of a ruggedly individualistic society. On the spurious plea of procuring the survival of the fittest, it permits the economically weak to be ground down under the heel of the strong, and adds to the devastation occasioned by lack of balance in production inevitable under a régime that precludes concerted planning. Of late years, under pressure of the direst necessity, and in the face of the most obstinate resistance, a greater willingness on the part of the individual to forgo insistence on his absolute liberty of decision in the wider interests of the branch of economic activity in which he is engaged has begun to manifest itself. Both at home and in the international field, where this tendency has prevailed, whole industries have been saved from a well-nigh hopeless outlook. Milk and bacon in this country, wheat and cotton in the U.S.A., tramp shipping, rubber, tin and copper in the world at large, are outstanding examples of

successful application of the principle of practical recognition of a community of interest between competing units in the same trade. Vastly important though these arrangements are, the bulk of production, domestic and international, is still carried on without plan to ensure that it shall accord with likely demand. This does not mean that the world could not consume far greater quantities of goods than it does at present. But for the disrupting forces we have described, production and consumption could be immeasurably expanded. No matter how high the level, however, unless production takes account of the proportions in which the available demand is likely to be spread over different categories of goods, disturbance is bound to arise. The goods relatively over-produced, even if cheapened in price, will not be fully absorbed, imposing contraction of output upon manufacturers with all its harmful consequences. These will not be compensated by unsatiated demand in other directions. Prices of the relatively under-produced goods may rise, but whilst they would thus absorb a greater proportion of available commodity money, this would serve merely to direct larger profits into few hands, an undesirable feature particularly so long as control over disposition of surplus income is lacking. Meanwhile the dislocation caused in the over-producing industries has adverse repercussions upon the entire economic position.

Under the New Order, then, the first and foremost task must be to control and harness those sinister forces above summarised that are bound, if left to run their course, to encompass the downfall of all ordered society. What that means events in the world around us have made abundantly clear.

So far as the financial system is concerned, gold must be relegated to its proper place.

Equilibrium in the international balance of payments must be deliberately aimed at, so that from this source disturbance, whether to the credit structure or to the stability of the foreign exchange position, can no longer be threatened.

The New Order must provide for full and constant employment of all productive forces of the nation in directions where such activity will yield the highest degree of well-being. Particular regard must be had to the requirements of the community in regard to imported goods essential to its sustenance and as raw materials for industry.

In the organisation of production consideration must be given to such goods as can be most advantageously exchanged for the products that need to be imported, after allowing for such of these as are received in fulfilment of current obligations due us from abroad in respect of capital supplied by us in the past. Domestic production retained and goods imported, in so far as these latter are not used in the process of domestic industry, together constitute the supply available to meet demand at home for consumption and finished durable goods.

The distribution of those goods over capital and durable goods on the one hand and consumption goods on the other, and, within these two main groups, over the numerous categories of articles that go to make up the internal economic interchanges, must conform to the balanced needs of a community whose productive forces are fully engaged at highest capacity.

The diversion of current commodity money from its proper function of circulating in the absorption of goods and services must be prevented by the marshalling of the flow of surplus income and undivided profits into channels that will complete and not disrupt the circuit flow of money.

The wasteful and suicidal policy of unrestrained competition—perforce bound up with lack of correlation between production and the balanced needs of the community—must be abandoned and planned economic activities based on scientific ascertainment of fact substituted.

The glaring inequalities inherent in our present system of inheritance and in the privileges which the possession of money ensures through education and nepotism are intolerable in a Christian state in which the well-being and the happiness of our fellow-beings must be of the same vital import to us as our own and that of our nearest and dearest.

The attainment of these objectives is practicable only at the cost of sacrifice. Unless the individual is willing voluntarily to relinquish the prerogative hitherto enjoyed of determining independently of others his policies in the economic and financial sphere under his immediate control, no progress towards a new order can be made.

The reason for the fanatical enthusiasm inspired by certain extreme political creeds must be sought in the fact that they contain a strong element of mutual self-sacrifice towards a common end. Alas, the ends pursued by the adherents of those creeds are not in harmony with God's spirit, since they include a large admixture of hatreds, the negation of our Lord's Commandment. Therefore, in so far as they violate God's laws, they are doomed to fail, as all that runs counter to His will ultimately must.

There is nothing in "rugged individualism" that can weld a nation together in a common cause, except it be a common desire to exploit fortuitous circumstances to personal advantage, regardless of the consequences to the commonwealth. Such a creed, though it may not directly propagate any principle conflicting with God's commandments, falls far short of His standards by its callous indifference to the effect upon others of the uncontrolled policies of the individual.

If the pernicious doctrines of physical and spiritual absolutism that now hold sway over large areas of the earth can arouse such enthusiasm, how much more should the task of working for the creation of conditions that shall conform to God's conception of His world!

In the realm of the complex and intricate problems of financial and economic reform the individual is powerless.

Only the joining hands of all inspired by love of their fellow-beings transcending all other considerations, under competent and God-directed leaders, can form that invincible yet peaceable army of "new men" that will inaugurate a new era.

Chapter 22

THE BATTLE WITH UNEMPLOYMENT JOINED

The most urgent task of the New Order is to find the answer to the problem of putting an end, promptly and once and for all, to the tragedy of unemployment.

The reform of our financial and economic system, proposals for which will be outlined in the succeeding chapters, is inadequate, alone, to achieve that object. It will eliminate the features that militate against stability and progress which we have summarised in the previous chapter, and will provide the means of consolidation and growth. It cannot, however, supply those dynamic forces required for wresting the host of our fellow-beings from the fatal grip of enforced idleness.

The impetus for overcoming the immediate and seemingly insuperable obstacles to the creation of work for the idle, and to the revival of international trade, must be derived from a complete change in outlook, not merely on the part of statesmen, but of every one of us.

Throughout I have refrained from advocating the scrapping of anything in our financial and economic system. I am seeking rather to adapt and to reform. One thing, however, must be scrapped most resolutely, and that is our fatal attitude of complacency with which we regard the misfortunes of others when they do not directly touch our interest; the smug self-satisfaction at the feeble palliatives administered; the self-congratulation at improvement largely fortuitous as the outcome of favourable combinations of circumstances, of which we are neither able to ensure the continuance nor prevent the reversal. By comparison with what still remains to be done, the slowness of the progress made should rather serve as a warning and preserve us from the danger of being lulled into a false sense of security.

Until we have dealt with the organic changes which a New Order will entail, it will not be possible to do more than set forth in general terms the practical implications of the new angle of vision that must be brought to bear upon our economic policies.

First and foremost, we must reverse our approach to unemployment. The piecemeal attempts to persuade, induce and cajole enterprise into employing labour are well-meaning but largely futile expedients, bound to be ineffective since they ignore the reality. Our starting point must be to recognise in its full significance the fact that more goods are needed and will be bought if the commodity money wherewith to buy them is distributed in the process of creating those goods, or others that can be exchanged for them, provided always that all current income and profits are utilised in the absorption of current goods and services.

The first step then will be the scientific ascertainment of what additional consumption could be expected if all those now unemployed were engaged in productive work at an average income of, say, at least £1 per week in excess of what they are now receiving. Some of our leading economists already have considerable experience in that type of enquiry, and it should not, therefore, meet with any difficulty. The additional goods that will be wanted will not be exclusively consumption goods but capital goods as well, because increased productive activity would result in additional profit and savings that could be invested in capital goods. An approximate estimate would have to be made of the increase in surplus income of individuals and undivided profit of enterprise thus becoming available for investment in current capital goods.

We shall then be enabled to calculate what would have to be imported from abroad, both for direct domestic consumption and as raw materials for transformation into other goods, in order to permit of the satisfaction of the demand for additional goods which had been ascertained.

The country would, in consequence, be placed in a position to take the initiative in approaching other countries with proposals to take more goods from them and to bargain

for the sale of an equivalent volume of our products in return. It would be a refreshing emergence from the deadlock of stagnation in international trade, and it is scarcely conceivable that such initiative could meet with anything but an encouraging response. If folly were to prevail and render negotiations along these lines abortive, it could only be a question of time before the statesmen who had cold-shouldered such opportunities were called before the bar of public opinion in their own country and the world at large. Wanton refusal to co-operate in bringing about a raising in the standard of living of the people could not be tolerated anywhere at any time, least of all in the sad plight in which the world finds itself at the present juncture.

Within our borders, the necessity of acquiring from abroad, in one form or another, a portion of the additional goods that would be needed under full employment, would involve the utilisation of part of the labour forces now idle upon the production of goods to be exported in exchange. The total product of all the workers at present unemployed —after deducting the goods so exported and adding such of the imported goods as would be received in the state in which they will be used or consumed—would then constitute the volume of supplementary goods which the preliminary statistical investigation had revealed as likely to be wanted at home upon the abolition of unemployment.

Training of unemployed would forthwith be taken in hand, not in the dreary consciousness of idleness at its termination, but in the certainty that jobs were urgently waiting to be filled. In so far as plant was lacking for part of the added production, it would first be constructed, if necessary under Government auspices.

For the moment suffice it that the ice would have been broken, both as regards unemployment and international trade. A stimulating current of hope and encouragement would be wafted through the distressed areas in our midst and the country at large, and would spread to and invigorate the atmosphere abroad by the welcome initiative of increased purchases that would radiate outward from this country.

There would be no need to wait for the rehabilitation of the entire world before we act. In fact, we should be giving the first decisive impulse towards it. Nor would it be imperative that the whole complex of measures that will establish the New Order should first be integrally operative. It is essential, however, that the maintenance of equilibrium in our international payment accounts shall have been deliberately assured, as otherwise the greater prosperity which would accompany full employment might entail indiscriminate increase in imports unrelated to the needs of the programme of production planned to end unemployment. We are aware of the dire consequences attendant upon deficitary international payment accounts, and nothing must be left undone to prevent such a contingency from arising.

Bank policy would have to be adjusted to the immediate additional need for credit which would be occasioned by this comprehensive increase in production. Under no pretext is the necessary increase in Bank of England credit, which would provide the banking system with the indispensable additional reserves, to be withheld or allowed to be reflected in a rise in the long-term interest rate. Thus we should effectively prevent the emergence of conditions involving the imposition upon the banking system of the necessity of realising securities. If permitted to arise, it must, in a very short time, defeat the entire effort at permanent recovery.

As for the disposition of surplus income and undivided profit, the tendency during the past few years has been for a greater volume of financial money to be transformed into commodity money than *vice versa*. Unfortunately it has lately been reversed, but it is likely to be again resumed and accentuated when the scheme above outlined is carried out. So long, therefore, as the upward economic trend continues, the plan to end unemployment can be put into effect without waiting for the control to which all new investment must be subjected under a New Order.

The steps above outlined would be but a beginning, though a vitally important one, towards that New Order. Its

significance would be not solely in the material benefits to be achieved, but in the consciousness that would pervade the entire nation that at last à new outlook had begun to break through.

The recognition that the responsibilities of the members of a community towards each other were being honoured in earnest would constitute a powerful unifying force. Based as it would be on mutual affection and interest, it would prove far more fruitful and enduring than the only one hitherto operative—common resistance to foreign aggression.

CHAPTER 23

A NEW INTERNATIONAL GOLD STANDARD

THE gold standard, as it was practised before its universal collapse, must be looked upon as the monstrous device of a soulless society for the automatic adjustment of disequilibrium in international financial relationships, regardless of the consequences to the community. These financial relationships, as we are aware, consist in current foreign trade, visible and invisible, payments in settlement of current international obligations, capital migrations divorced from goods, and the self-balancing item of capital exports in the form of goods.

Discrepancies in the balance of international payments were taken for granted. To the deeper causes scant attention was paid, until the devastating effects had brought the world to the brink of chaos.

Their roots lay in divergent trends, as between different countries, of financial, economic and politico-social policies (tariffs, State finance, credit policy of the banking system, etc.). These were reflected in the evolution of domestic price levels, the course of international trade, the conduct of capitalists. The forces released were left free play. Control over the items composing the balance of international payments would have been rejected as a violation of the absolute discretion in the economic and financial sphere which the individual claimed as an indisputable right.

The brutal inhumanity inherent in the operation of the gold standard was the consequence of the dual function imposed upon gold. The same gold had to be available to meet any deficiency in this unplanned and uncontrolled complex of international payments, and to serve as the basis of currency and credit—in fact, under our own system, as the sole basis.

Even in countries where currency and credit systems

were not exclusively dependent upon gold, its outflow involved precautionary contraction of credit, inasmuch as the proportion of gold to liabilities at the Central Bank was everywhere subject to a legal minimum.

Thus, to meet adverse international accounts resulting from unchecked imports or unsynchronised and unbridled cross-movements of capital divorced from the movement of goods and undertaken from purely selfish motives, the entire community was penalised by the ruthless contraction of credit which was the inevitable corollary of gold export. In the chapters on foreign trade and foreign lending the consequences of such contraction have been traced. They are all the more disastrous coming, as they do, as the culmination of excess imports of goods or exports of capital, developments in themselves disruptive of the circuit flow of money.

That, before the War, the gold standard was made to function comparatively smoothly between a limited number of countries was due to the relative smallness of capital migrations divorced from goods, which moreover were generally of a temporary nature; to the steady increase in the production of gold, approximately commensurate with the increase in population and production; to the quasi-monopolistic position occupied by London as a banking and financial centre, which rendered the response to changes in its bank rate prompt and effective; and to the country's supremacy in manufacturing industry, which ensured that domestic funds employed in long-term capital investments abroad were utilised in the form of goods made here. The transfers of gold from one international centre to another would appear insignificant in comparison with the huge movements of recent years, and the automaticity of the reactions provoked by variations in the short-term interest rate ofttimes permitted of the necessary adjustment of temporary discrepancies in the international balance of payment being effected without too severe a repercussion upon the domestic economic position. Nevertheless growing unemployment had already become a distinctive feature of successive cyclical depressions in those days, though the

latter were not generally recognised as a direct corollary of the conduct of money economics, of which gold policy was but one of the disintegrating features.

The War brought about so fundamental a revolution in financial and economic international relationships that all essential presumptions for the working of the gold standard were swept away. The huge increase in the creation of money in relation to goods as a result of the War had deprived the pre-existing fixed money equivalents for gold in each country of any intrinsic validity. Money everywhere purchased but a fraction of the goods obtainable with the same amount prior to the War. It was incongruous to expect gold alone to be immune from inexorable economic laws. The undervaluation of gold in terms of money, however, was widely disparate as between different countries, according to the relative burden of the War expenditure incurred and the policies followed in financing it. Nor was this all. Balances of international payment accounts were swollen to fantastic dimensions by imposition of reparation payments and by the international obligations involved in loans raised abroad by the allied belligerents.

Had the proportionate measure of depreciation of the money in each country been scientifically ascertained and had the suicidal influence of the huge transferences of capital, dictated by the Peace Treaties, been appreciated in its true significance, an agreed universal revaluation of gold might have been simultaneously undertaken and the world might have been saved the convulsions, economic, financial and political, which we have witnessed and the effects of which are still rampant in many directions.

Instead, the money equivalents of gold were fixed in each country independently according to the prevailing conception of its national interests, and in some cases—notably our own—in complete disregard of the reduced value of money in terms of goods. The rates of foreign exchange which gave expression to these discrepant appraisals of gold in the different countries were bound to reveal the resultant distortion of the relationship between the respective price levels of goods. Moreover, no action was taken to halt the

devastating forces unleashed by the gigantic inter-State money obligations. At times their ravaging effects were partly concealed and held in check by short-term capital migrations in the opposite direction on an equally unprecedented scale, but when the trend of these latter was reversed, they reasserted themselves in their stark malignancy, bringing about the successive disintegration of one national economy after another.

The story of the suffering entailed by the grim determination to perpetuate an untenable position, the true nature of which was nowhere grasped until it was too late, is too fresh in everybody's mind to need elaboration here. In fact, it is still being written in the daily lives of the unfortunate victims of those disastrous policies. Would that others could have learnt from our dismal experiences. Astounding as it may seem, that same obstinate tenacity in defending and bolstering up a tottering edifice marked the policies of other gold countries, notably France, long after events here had demonstrated the fallacies on which it was based. It is, however, a safe axiom that nothing is ever done in public affairs except under pressure of inescapable necessity, when, in fact, it becomes more dangerous for those at the helm to do nothing than to take action, even if such action does involve departure from precedent, prejudice and fetish.

It may be readily conceded that gold for the settlement of international accounts has unique advantages, which are possessed by no other known substance in the same degree. The criterion of its suitableness for that purpose must be universal acceptability, and this is unquestioned. It is accounted for by the fact that everywhere it is exchangeable for money, either at a fixed or fluctuating rate. Thus, in its case, there is no problem of saleability. In this it contrasts with all other commodities. The implications of this special position of gold require to be fully understood.

In the first place, its very production is a stimulating factor upon the price level of goods, and thus provides an inducement for increased economic activity. Whereas other goods depend for their absorption upon willingness of

owners of existing bank deposits to part with this money in order to receive the goods in exchange, or upon readiness of the banking system to grant loans to intending purchasers for the financing of the goods, gold, once available for disposal, is in an entirely different position. To be turned into money it only needs to be tendered to the Central Bank in the country in which it is produced, or in any other where gold is accepted at a fixed price, for the seller to receive in exchange a new credit balance or new currency. The new money will cover not merely the cost of production but a profit as well. An amount equivalent to that expended in connection with the production, transport and disposal of the gold, plus the amount of the profit, is thus set free to swell the volume of commodity money available for the absorption of other goods, since the gold itself does not require to be absorbed from that source. In the case of other commodities, there are—*ceteris paribus*—no sources from which they can be absorbed, outside the money disseminated in the process of their creation and distribution, and this, as we know, is adequate only provided all profits and surplus income are re-spent on goods and services.

Thus, when gold is disposed of to a Central Bank, the proportion of commodity money to goods requiring to be absorbed is increased, with resultant rising tendency of the price level of goods.

Apart from this direct impulse to the demand for goods which gold provides by virtue of its exchangeability for money in most money systems, it possesses a potential energising influence on the body economic. This is inherent in the special position which gold in the hands of Central Banks occupies in relation to the extension of credit. Under the existing financial order, gold in the principal gold-holding countries is an indispensable and, in our own system, ultimately the sole basis for the extension of credit by the banking system. As we have seen from our study of the technical working of our own system (Chapter 4, " Gold and Bank Money "), acquisition of gold by the Central Bank permits of the creation of bank money many times its volume. Such additions to the gold stock thus enable a

larger volume of trade at higher prices to be financed by the banking system through additional commodity loans, without the nefarious consequences attendant upon such expansion of loans when effected at the expense of contraction in another direction, *i.e.* through sale of securities by the banking system.

As against the invigorating effect of the acquisition of gold by Central Banks, there is to be set the credit contracting, and ultimately economically destructive, influence of persistent exports of gold from non-gold-producing countries out of the stocks of the Central Banks. Under the gold standard our banking system was normally expanded to its full limits. Hence the sale of gold by the Central Bank on any substantial scale necessitated contraction of credit, all the more merciless because gold was (as it still is) the exclusive basis for the credit structure. The futility of bank-rate policy as a weapon against fundamental causes productive of persistent adverse balances of international payments has been amply demonstrated in the past. We need not here enlarge upon the fatal consequences of the operation of our financial system in these circumstances, as we have dealt with this aspect in earlier chapters. Although the old gold standard has made way for a managed currency, there is no change in the structure of our credit and currency system, of which gold still remains the sole ultimate foundation. Nor do the deflationary tendencies of our money authorities appear to have been modified, although nominally it is claimed that the Treasury sets the tune. In spite of vast accretions to the gold holding, the banking system has been forced to sell securities and reduce its holdings of liquid assets in order to supply the increased demand for trade loans. Thus the long-term rate of interest is slowly but inexorably being forced up. This is solely due to the Bank of England having failed to enlarge the basis of the banking system's credit-expanding capacity, *i.e.* the banking system's deposits at the Bank of England. The foundations for the slowing up of our economic development are being laid while nearly two millions of our workers remain idle!

In the foregoing we have considered gold from the standpoint of its influence upon the money flow. Let us devote a few observations to its position as a factor in international trade. So far as the gold-producing countries are concerned its export serves the same purpose as any other. It affords to them the means whereby goods needed from abroad can be paid for. There is, however, as we are aware, this vital difference with other goods exported, that sale at a profit is assured. As ownership of the gold mines is, in the main, concentrated in London, a large part of the output is marketed there. It is not the amount of gold imported, however, but the retained imports that interest us. In so far as the gold imported and retained is used for industrial purposes it is a commodity like any other. If it is hoarded for foreign account it has no more direct significance, from the point of view of the importing country, than any other valuables received for safe-keeping. If the import and hoarding takes place for domestic account, and does not represent repatriation of domestic capital previously held abroad, the gold enters into the settlements of the international balance of payment through the foreign exchanges. However, it entails no effect upon the money flow different from that of any other import stored away. On the other hand, retained imports of gold when sold to the Central Bank, whatever may be the character of those imports, cause, as we are aware, an increase in the volume of money relative to the volume of goods to be absorbed. The additional money, however, is not necessarily available for the acquisition of goods. In so far as such gold sales to the Central Bank represent influx of foreign capital, the new money created by the Central Bank will pass into foreign ownership. It is likely either to remain unemployed or to circulate amongst holders of securities, thus rendering the increase in money ineffective as a directly stimulating element in the price structure or production of goods.

When retained imports of gold are sold to quarters other than the Central Bank—for instance, an Equalisation Fund—such new money as may come into existence in these circumstances is of a different character. It is not money of

the highest grade of potency which only the Bank of England can create and which, when gold is bought by the Central Bank, is represented by the currency transferred to the Banking Department of the Bank of England. The Equalisation Fund will have to obtain the money required to pay for the gold acquired, by sale of securities—for instance, Treasury bills. If these are purchased by the banking system, the new money created will be bank deposits and the ratio of the reserves of the banking system to its deposit liabilities will deteriorate. If it is not desired that this proportion should fall, other assets must be sold by the banking system or the Bank of England must buy securities in order to enlarge the reserve of the banking system. The Bank of England's own reserve ratio, in that case, would decline.

If the Treasury bills sold by the Equalisation Fund were bought out of existing bank deposits there is no change in the volume of money, but clearly this could not happen to any extent, as there is no appreciable volume of existing deposits whose owners would be prepared to utilise them in the purchase of Treasury bills.

If the additional Treasury bills were bought, not by the banking system, but by the money market and by institutional investors out of money borrowed from the banking system, new money would be created as a result of these loans. The effect upon the reserve position of the banking system is the same as if the Treasury bills had been purchased by the latter. Either the banking system's reserve ratio or the Bank of England's reserve ratio suffers, or both. This can be reversed at any time by sale of gold out of the Equalisation Fund to the Bank of England, and utilisation of the proceeds in the repayment of Treasury bills. In that case the effect is as described when importers of the gold sell it direct to the Central Bank.

In previous chapters we have examined the reactions produced upon the body economic by disequilibrated international payment accounts. We are also aware of the implications of the dual function of gold as sole ultimate means of settlement of deficiencies in those accounts and

at the same time as basis of the credit structure. In the light of these considerations we are now in a position to formulate the essential prerequisites of a new international gold standard.

It would be unavailing to lay down conditions of which the fulfilment depends upon policies of other nations. If the new international gold standard is to have any permanence so far as this country is concerned, we must frame its rules so that they are capable of being observed by ourselves without a general breakdown being necessarily entailed when others depart from them. It is also desirable that they should involve as little departure from the customary conduct of current business as is consistent with the protection of the community against the evils of the present deplorable anarchy in the conduct of international economic and financial relationships. There can be no whittling down of those indispensable safeguards. Here I shall do no more than briefly outline the conditions and develop some of their aspects further in subsequent chapters. A balanced budget of current Government expenditure—as distinct from Government expenditure on new capital assets—is throughout taken for granted.

The conditions precedent to the re-establishment of an international gold standard and the measures requiring to be adopted to ensure stability, and immunity from disruption through default of other countries to honour the obligations involved, are set out below:

(1) Control of the balance of international payments with a view to achievement of equilibrium so far as this country is concerned. This is a fundamental condition, and without its fulfilment there can be no assurance of permanence in any arrangements for the stabilisation of the foreign exchanges.

The equilibrium to be arrived at would result as nearly as possible in equality between the offer of bank balances in our system with the object of acquiring balances in banking systems abroad, on the one hand, and demand for domestic bank balances in return for the cession of a bank balance abroad on the other.

To achieve this the international balance of payment must be divided into its component elements and equilibrium established in each as follows :

i. Current imports and exports of goods and services, including gold imported for industrial purposes, and allowing for current international obligations (interest, dividends and amortisation) receivable and payable, shall be in balance.
ii. No export of domestic capital shall be made other than in the form of goods.
iii. Any inflow of foreign capital or repatriation of domestic capital shall be offset by acquisition of the corresponding gold or foreign exchange, and any repatriation of foreign capital shall be offset by sale of the corresponding gold or foreign exchange.

The implementing of the condition specified under (1) will involve the following measures :

(*a*) Provision of adequate machinery to ensure the balancing, at the highest possible level, of our international exchanges of goods and services after allowing for the current invisible items which enter into the international payment accounts.
The settlement of such minor and purely temporary discrepancies in the current balance of payments, which are inevitably associated with arrangements covering such a vast field, are to be effected in gold or foreign exchange out of the Gold Settlement Fund. (See under (3).)

(*b*) Centralisation of fresh emigration of domestic capital with a National Investment Authority who will ensure that foreign lending takes place only in the form of goods.

(*c*) Retention in the hands of the Gold Settlement Fund of foreign exchange and gold equivalent to amounts repatriated from time to time of domestic capital abroad. In so far as not needed to strengthen the Gold Settlement Fund, the gold or foreign ex-

change is to be placed at the disposal of the National Investment Authority for re-investment abroad. The capital of such investments will serve as a means of financing war supplies should the need arise, and the income in times of peace will secure annually the import of additional supplies of raw materials, etc., required at home.

(*d*) Retention in the hands of the Gold Settlement Fund of foreign exchange or gold equivalent to fresh immigration of foreign capital. On the other hand, repatriation of foreign capital held here would be accompanied by cession of a corresponding amount of foreign exchange or export of gold out of the holdings of the Gold Settlement Fund.

(2) Gold to be divorced from the credit structure. It is monstrous that adverse balances of international payments which, in themselves, as we have seen in earlier chapters, are nefarious in their influence upon the domestic interchanges of goods and services, should be permitted to culminate in the complete disruption of these latter through the weakening of the base of our entire credit structure. The segregation of the two functions of gold will necessitate the remodelling of the credit system so as to abrogate its ultimate dependence primarily upon gold and secondarily upon mainly non-productive and non-self-liquidating assets.

(3) A Gold Settlement Fund is to be constituted to be administered by a Foreign Exchange Board. It will, in the first place, be composed of gold withdrawn from the Bank of England's holding, Government debt to be substituted in the Issue Department of the Bank of England. An amount of £100 millions, after revaluation, would be left in the Bank of England to serve as an Emergency Settlement Fund, but it is improbable that it would ever be required.

In the second place, the gold and foreign exchange in the Exchange Equalisation Fund is to be transferred to the Gold Settlement Fund. These holdings are already financed by Government debt.

The initial amount of gold and foreign exchange which would thus be transferred to the Gold Settlement Fund would be checked against the amount of short-term foreign capital calculated to be held in this country, not, of course, including gold hoarded here by foreigners, but allowing for reserves of foreign and dominion Central Banks held in sterling. From this estimate would be deducted the volume of current account balances normally maintained here by customers abroad for the purpose of carrying on their current transactions in the London market. To the difference would be added a margin of safety to cover any likely temporary deficits in the controlled balance of current international payments. A sum of £50 millions should be adequate for this latter purpose.

Should it be found that the Gold Settlement Fund did not, at the outset, reach the level aimed at, the gold or foreign exchange acquired as a result of repatriation, from time to time, of domestic capital employed abroad would be added to it until the desired amount had been attained.

(4) All foreign exchange transactions, both for account of domestic and foreign customers, including Governments and Central Banks, would be conducted by the banking system and licensed dealers for account of the Foreign Exchange Board. Steps would be taken to ensure that the foreign exchanges would not be used for the private emigration of capital. All other transactions would be classified under the following groups, to which end the necessary data would have to be supplied by the parties concerned:

(*a*) Settlement of imports and exports of goods and services.
(*b*) Interest, dividends and repayment of debt receivable in respect of foreign investment or capital abroad domestically owned or payable in respect of domestic investments owned by foreigners or foreign capital held in this country.
(*c*) Immigration of foreign capital.
(*d*) Repatriation of domestic capital.
(*e*) Withdrawal of foreign capital.

No hindrances would be placed in the way of immigration of foreign capital in view of the difficulty of intervening in the transactions of foreign nationals. Pending legislation by others to prevent capital outflow from their countries such immigration would be rendered innocuous here by the addition of foreign exchange or gold to the Gold Settlement Fund equivalent to the volume of such fresh influx of foreign funds.

(5) The hoarding of gold in this country would be prohibited, whether for domestic or foreign account. The hoarding of currency would, of course, also be prevented, but under the new credit system to be outlined in a succeeding chapter it is not likely to arise.

All gold in the open market would be bought for account of the Gold Settlement Fund, which would supply the needs of industry through the customary channels. It would also sell gold for prompt re-export, provided the corresponding foreign exchange resulting from the export were simultaneously ceded to it. Gold would further be sold by the fund to meet withdrawals of foreign capital or current indebtedness abroad in respect of goods and services, or current financial obligations for interest, amortisation or dividends, etc. Gold would only be made available, however, if the cost of remitting through the foreign exchanges was greater than the cost of shipping gold—in other words, if the exchange value of our money in terms of other moneys had fallen below gold export point. Under the system we have described this would be entirely in the control of the Foreign Exchange Board.

(6) No loans for other than self-liquidating commercial purposes may be granted to foreign customers by the banking system. This restriction will apply equally to domestic borrowers, and will prevent creation of bank money for other than genuine trade purposes. So far as foreign interests are concerned, it will also ensure that our foreign exchanges cannot be influenced by them through the command of bank balances representing additions to the money flow.

(7) Fluctuations in the exchanges would be kept within

circumscribed limits by reciprocal arrangements amongst gold-holding countries for definite restricted periods, subject to extension from time to time, involving an undertaking to part with gold for export whenever the exchange value of the money of any of the parties in terms of any other had depreciated to an agreed figure. It might be erroneously supposed that, even without such agreement, our own exchange would not be subject to fluctuations of consequence so long as equivalence in offer of and demand for sterling bank balances were assured by the measures above outlined. Such equilibrium could not, of course, prevent unbalanced international payment accounts of other countries from disturbing the relative value of the moneys of other countries in terms of ours, in the absence of arrangements of the type above indicated between ourselves and each of the countries concerned. The money of a foreign country with a persistently adverse balance of payment would then be bound to depreciate in terms of our money as compared with the money of another country with a persistently favourable balance. However completely equilibrium in our balance of international payments had been established it would be bound to be upset by such developments elsewhere over which we could exercise no control. Trade could not be kept within the channels previously negotiated if material changes in the relative value of the moneys of foreign countries were to occur. That contingency is met by the reciprocal arrangements proposed. It is on the lines of those now in force between a number of countries, except that none of the conditions essential to their permanently successful application have so far been fulfilled.

The price of gold in the open market could be left to find its own level, under the general direction of the management of the Gold Settlement Fund. It is of no interest to the business community, which is concerned only with rates of exchange, the stabilisation of which within certain limits is all that is required. In practice, the market price of gold would not necessarily be affected by fluctuations of the exchanges within those limits, but its extreme

range of variation would be governed by the position of the exchange between ourselves and that foreign country which had the narrowest margin between the price at which its Central Bank was willing to buy and to sell gold. All danger of gold being acquired for purposes inimical to the welfare of the community would have been eliminated by the provisions against hoarding and by the limitation of domestic capital emigration to operations that would take the form of export of goods.

(8) In view of our inability to enforce equilibrium in the international balance of payment as between other countries, or to control their domestic financial policies, it is incumbent upon us to envisage the conditions that would arise in the event of a breakdown in the stabilisation arrangements through persistent depreciation of the money of any of the participants in terms of goods. The resultant dislocation of our international trade in such circumstances must be promptly and energetically met by revision of the trade treaties negotiated under the new order. All these treaties must provide for such revision in case of depreciation, by an agreed percentage, in the exchange of either party in terms of the money of the other as compared with the level at which it stood when the treaty was concluded. The object of the new negotiations must not, in the first place, be protection against dumping, but must aim at the greatest possible increase which the depreciation of the other country's money would enable us to make in our volume of purchases, so as in turn to ensure that no reduction in purchases from us need be made by that country. Though the increased volume of our purchases need not necessarily involve an increased amount in sterling because of the depreciation in the value of the foreign money in terms of ours, there is always the possibility that reduction in price of certain goods might increase the demand beyond the proportion corresponding to the decline, whilst in other cases the stimulating effect upon demand may be much less marked. The ascertainment and appraisal of such probabilities needs scientific planning. It would be time and thought better spent than in the indiscriminate clapping on

of countervailing anti-dumping duties, though it may be necessary to resort to the imposition of such duties in the case of purely competitive goods.

Inasmuch as equilibrium in our own international financial relationships would be assured, there could be no cause, other than the altogether unlikely one of a downward revision of the money price of gold anywhere, why any money should appreciate in terms of ours beyond the limits agreed upon, as we should permanently and without disturbance to our credit system at any time be in a position to meet any temporary deficiencies in our international balance of payments out of the Gold Settlement Fund.

The old gold standard has " liquidated " itself by the operation of laws that cannot be indefinitely defied. A new one is being evolved, but, alas, upon insecure foundations.

It may be admitted that some of the most glaring perversions of the functioning of an international gold standard have been eliminated as the result of cessation of reparations and War debt payments and of the revaluation of gold in terms of money. The germs of fresh disintegration, however, are rampant in uncontrolled capital movements, disequilibrated international trade, unbalanced budgets, political uncertainties.

It must be emphatically insisted upon that no action binding the country again to an international gold standard shall be undertaken until the latter has been finally removed from the plane of a facile means of adjustment of uncontrolled discrepancies in international payments, the size and incidence of which is left at the mercy of our own lack of forethought and similarly undigested policies of others. Mastery over the elements that govern international financial relationships is an indispensable prerequisite to the assumption of commitments for the unconditional liquidation in gold, at an agreed price in our money, of any deficiencies in the balance of international payments.

It may be asked, what is to become of the gold-mining industry if gold were not any longer required anywhere as a basis for currency and credit. Its current uses would then be confined to industry and to the settlement of balances in

international payments account, and these latter would be reduced to modest proportions. Probably not more than 50 per cent of production could be absorbed for these purposes.

Of course, automatic saleability in all principal countries against the money of each would be assured under reciprocal agreements as indicated above, but it would not be advisable that gold should be dumped just wherever, for the time being, the exchange rate happened to ensure the most favourable market.

It must be remembered that under consciously equilibrated current international payment accounts, and with capital movements offset as outlined in this chapter, retained gold imports not accounted for by capital migrations will render a corresponding reduction in merchandise imports inevitable.

It would seem, however, well within the capacity of every nation, and it certainly would be within ours under the New Order, to absorb annually a certain proportion of the new gold production over and above the amount currently needed for domestic industry. The gold so acquired would have to be regarded as a hoard, State owned, to be paid for out of domestically borrowed money to be supplied by the National Investment Trust, to which we shall refer in the next chapter.

In the trade treaty to be negotiated with South Africa, then, provision would be made for the import of a given quantity of gold of which part would be purchased by the Government. The object of the purchase would be the building up of a gold reserve to be available in the event of war, but all or any part could, of course, if so desired, be utilised at any time in peaceful pursuits, such as the acquisition of assets abroad, the income of which would enhance our future well-being by permitting increased imports of goods. As a war chest the gold would, of course, be a sterile holding, involving an annual charge upon the taxpayers to meet the cost of borrowing for the financing of the purchases. The sacrifice would, however, be insignificant in comparison with the advantages to be gained.

These include not only added security against famine in war, but the orderly marketing of gold and the maintenance of the gold industry, at least so far as we could contribute towards those ends.

The dangers of gold being over-produced would not, for some time, be great if the world would return to political and economic sanity. Should, however, at some future time gold be in excess supply, there could be no more reason why the gold industry should be immune from the need for regulation of production any more than rubber, tea, copper or other industries, which have voluntarily imposed such restrictions upon themselves in the full recognition that, failing such measures, reduction of output would be accomplished by the crude means of survival of the fittest. The folly of that utterly selfish course is by this time universally acknowledged. Ordered society would not survive the attempt to apply it again.

Chapter 24

SURPLUS INCOME AND INVESTMENT UNDER THE NEW ORDER

Having outlined the measures by which the circuit flow of money is to be protected from disruption by causes inherent in external financial relationships, we now turn to attack the destructive features in our domestic money economics.

No lasting exemption from the disastrous cyclical depressions can be achieved so long as it is possible for part of the flow of money, disseminated in the creation and distribution of goods and services, or forming part of the price asked for goods and services, to be diverted to purposes other than the absorption of current goods and services, without conscious effort being made to ensure that the compensating factors, if any, are adequate to restore the flow.

If we are to achieve a continuous and even circuit of money amongst goods and services we must eliminate, or counteract, variations in the volume and direction of that flow, in so far as not conditioned upon the needs for the financing of production and interchange of goods and services planned at the highest conceivable pitch consistent with the productive resources of the community.

We are aware, from our survey of the working of our money economics, that the banking system under the present order can and does contract and expand the total volume of money independently of the volume of economic activity. We have reviewed the implications of this so-called bank policy. The reform of the Bank of England and of the banking system, with which we deal in the next chapter, will provide for the abrogation of this power.

Bank policy cannot, however, directly vary the volume of money circulating amongst goods and services. Changes

in that flow can be brought about only by action at the initiative of the public in regard to money owned or borrowed by it, however much the sense in which that initiative is exercised may be influenced by bank policy. We are already familiar with the various forms which that initiative may take, from our analysis of the money flow in an earlier chapter, and with the results, stimulating or depressing and ultimately disintegrating, as the case may be. Nevertheless, in order that we may form a clearer conception of the problem to be tackled, we set out below, in juxtaposition, the opposing groups of operations, with money owned or borrowed, bearing upon the money flow amongst goods and services and thus upon price trends.

Expansion or contraction of the aggregate volume of money occasioned by changes in the amount of genuinely self-liquidating bank loans have not been included. The characteristic of a self-liquidating loan is that it is repaid within the normal trading periods out of the proceeds of the very goods financed. Thus, an amount corresponding to the new money represented by the loan is, within a brief space of time, again withdrawn from the commodity money flow, and cancelled by the bank in extinction of the loan. Under the New Order the volume of such loans would fluctuate solely in response to the varying needs of planned production and foreign trade. Hence they would not in themselves bring about a change in the ratio between goods to be absorbed and money available for their absorption.

SUMMARY OF CHANGES IN CIRCUIT FLOW OF MONEY AMONGST GOODS AND SERVICES IN VITALISING OR DEPRESSING SENSE, ARISING FROM INITIATIVE OF PUBLIC—AS DISTINCT FROM BANKING SYSTEM—IN DEALING WITH MONEY BORROWED, OWNED OR CONTROLLED

VITALISING	DEPRESSING
1. *Increase in volume of money circulating amongst goods and services by expansion in total volume of money through borrowing from the banking system :*	1. *Diversion from flow of money circulating amongst goods and services of funds belonging to following categories :*
(a) *For the financing of non-self-liquidating assets :* By non-self-liquidating assets	(a) Current surplus income of individuals. (b) Current undivided profit of enterprise.

VITALISING (contd.)

we understand assets the cost of which is not normally defrayed out of current income or revenue within a brief period of, say, 3 to 6 months. This type of financing includes *i.a.* construction of plant, machinery, buildings, installations, etc.

(*b*) *For the financing of instalment buying :*
In this type of credit the transactions do not generally cover assets of the non-self-liquidating class. It is frequently resorted to in cases where the amount involved in the purchase, in relation to current income or revenue, is greater than can conveniently be met in prompt cash or within a brief period.

(*c*) *For speculative purposes :*
In so far as the proceeds of such loans are utilised by the borrowers for the acquisition of goods or payment for services, a transitorily stimulating effect upon the money flow amongst goods and services is exercised. If used to finance the acquisition of existing capital assets (land, buildings, securities) they could only stimulate the interchange of goods and services indirectly, in the same way as an increase in the total volume of money resulting from bank policy. Under the New Order, creation of bank money for speculative purposes will not be permitted.

2. *Increase in volume of money circulating amongst goods and services without increase in total volume of money :*

This arises from decision to employ in acquisition of goods or payment for services, or in purchase of new securities, proceeds of which are to be spent upon goods and services, existing capital funds previously not so used. The decision may be taken :

(*a*) Directly by owners or controllers of idle deposits or of deposits previously engaged in

DEPRESSING (contd.)

(*c*) Other sums forming part of the price obtained for goods and services (such as reserves of every description) in so far as they are not re-spent upon goods and services directly or through acquisition at issue of new securities of which proceeds are so spent.

The forms which this non-spending upon goods and services of funds derived from sources (*a*), (*b*) and (*c*) takes are summarised below.

i. Acquisition of existing capital assets (existing securities, buildings, land) directly or through investment in investment trusts. Repayment of bonds, mortgages and other forms of capital indebtedness is assimilable to acquisition of existing securities, etc.
ii. Leaving such funds idle in banking account.
iii. Deposits in savings banks (including P.O. Savings Bank).
iv. Payment to insurance companies of premiums to insure future capital payments or of lump sums to insure annuities.

2. *Withdrawal from flow of money circulating amongst goods and services of capital funds previously so engaged, the total volume of money being left unchanged :*

This arises from decision to leave funds previously used as working capital in enterprise, idle on deposit or to utilise them in other forms which do not involve re-spending upon goods and services. (See point (1) i, iii and iv.)

VITALISING (contd.)	DEPRESSING (contd.)
turning over existing securities and other existing capital assets. (*b*) Indirectly by owners and controllers of securities, insurance policies, mortgages and other capital assets, in respect of the capital sums received by them upon sale, redemption, repayment, etc., in so far as this money, prior to being paid over to them, was idle or engaged in turning over existing capital assets.	
3. *Restoration to flow of money circulating amongst goods and services of funds diverted from the same* through non-spending of current income or revenue upon goods and services. (Point (1) depressing factors.) This restoration arises from : (*a*) Purchase at issue of new securities the proceeds of which are to be spent upon goods and services, or financing of new building by savings banks, insurance companies, investment trust companies, building societies out of current accretions to their funds in so far as derived from sources indicated under point (1) (*a*), (*b*) and (*c*) of the depressing factors. (*b*) The decision of recipients of capital sums (see point (2) (*b*)) derived from the sources indicated under point (1) (*a*), (*b*) and (*c*) of the depressing factors, to utilise the funds received to acquire goods, pay for services or purchase new securities of which the proceeds are to be spent upon goods and services.	3. *Withdrawal from flow of money circulating amongst goods and services of funds previously added to it, and involving reduction in total volume of money.* This arises when there is on balance a reduction in bank credit, through repayment of : (*a*) Non-self-liquidating bank credit ; (*b*) Instalment purchase bank credit ; (*c*) Speculative commodity bank loans ; out of funds which, prior to being used to effect the repayment, had been utilised in turning over goods and services. The money (bank deposits) is actually cancelled in the mechanism of repayment.

The actively depressing factor of diversion of current commodity money from absorption of current goods is ever with us. Its virulence may be temporarily checked, and at times outweighed, by the stimuli, active and corrective, associated with a period of economic recovery. Under our present order, however, as we have demonstrated in earlier chapters, the latter are foredoomed in due course to be smothered by the disruptive elements. Though the volume

of some of the items contained in the above summary can be readily ascertained, concerning others no adequate data are available and no conscious effort has, to my knowledge, been made to correlate them and gauge their effect upon the circuit flow of money amongst goods and services.

When the inexorable cyclical downward trend sets in we begin to cast about for means to arrest it. These can be no more than palliatives so long as the root causes are not removed. The puny correctives to which we are restricted under our present order, if we are not to risk insolvency, are of no avail against the onslaught of the devastating forces left free to run their course. Not until we cease to look upon the trade cycle as a visitation of the elements to which we must submit whilst protecting ourselves as best we may, not until we realise that this scourge is man-made, and therefore capable of being surmounted by the effort of man, shall we be in the frame of mind to administer treatment to which it will yield. The price of victory, let it be clear, is willingness on the part of the individual to subordinate to the welfare of the community as a whole certain prerogatives in regard to the disposal of his money hitherto taken for granted. It may be well to remember that no supposed right is valid, nor likely to go unchallenged indefinitely, of which the unrestricted exercise can be proved to inflict grievous injury upon the body economic. Reform is the more urgent since the dire consequences of the present system are visited with particular severity upon the very elements which, by reason of their lack of resisting power, are entitled to our special solicitude.

The prerogatives referred to involve the diversion from the absorption of goods of funds which, all other things being equal, are indispensable for this purpose. It is brought about, as we are aware, by the absolute discretion to invest as they please enjoyed by individuals in regard to their surplus income, and by those in control of enterprise in regard to any profits not distributed to shareholders, partners or owners, or any other sums included in the price obtained for goods and services and not re-spent upon goods and services.

In part, that right to dispose of funds is transferred to enterprise concerned with reinvestment, such as life insurance companies, savings institutions, building societies, investment trust companies. The investment of accretions to the funds of enterprise of this type, in so far as derived from the sources above indicated, is assimilable, in its effect upon the money flow, to direct investment by those who supplied the funds. In the case of life insurance companies, of course, the increase in funds is but part of the money received by them out of current income of the public. The increase shown is the residue after payment by the companies of capital sums in respect of life insurance policies. Except to the extent that current receipts of the life insurance companies did not emanate from current income or profits, those capital payments also require to be restored to the flow amongst goods and services. The same applies to all other capital payments effected out of profits and surplus income (repayment of debt of every description).

Equally unfettered, under the existing order, and uncoordinated with the state of the flow of money, is the decision of owners of existing bank balances representing past profits or surplus income, to use the same in, or withhold or withdraw them from, acquisition of goods.

It must be one of the chief aims of the New Order to ensure that any conflict between this unrestricted freedom in the field of investment and the paramount need for preventing impairment or disruption of the interchange of goods and services shall be eliminated.

To this end the National Investment Trust will be created, which will be directed by the National Investment Board. In its hands will be centralised all financing of new capital assets and of additional permanent working capital required by enterprise, in so far as not met by enterprisers out of their own resources.

It will have two subsidiaries : the National Mortgage Institute and the International Investment Trust. The former, apart from other functions, will act as a channel on behalf of the National Investment Trust for the provision of additional funds on mortgage, along lines indicated below.

The International Investment Trust will handle all foreign financing, which, under the new order, will be supplied in the form of goods only.

Within the needs of planned economic activity and the limits set by the community's current saving capacity, the National Investment Trust Company will marshal the flow of money amongst goods and services.

Reform of the banking system, to be described more fully in the next chapter, will include the abrogation of so-called "bank policy". All influences upon the commodity money flow resulting from the sole initiative of the monetary authorities will be ruled out.

The scope of the control to be exercised by the National Investment Trust thus becomes simplified. It will be confined to circumscribing the initiative on the part of the public in the field of investment, and to correlation of the elements which determine the amount on balance available for new investment and its apportionment over new means of domestic production (plant, etc.), additional working capital for domestic enterprise and the goods needed by foreign interests as the outcome of foreign financing.

The measures to enable the Trust to carry out its functions are so devised that, with certain adjustments, to which reference will be made, the volume of money available for these purposes, and necessary for maintaining undisturbed the relationship between goods to be absorbed and money applicable to their absorption, shall be automatically ascertainable at all times.

The only security available to the public for new investment under the New Order will be the shares of the National Investment Trust. Existing securities may be acquired only out of proceeds of sale of other existing securities by the owners.

The amount of the ordinary share capital of the National Investment Trust will be indeterminate. As will be seen, it will fluctuate constantly.

The shares will be entitled to a minimum dividend of 3 per cent guaranteed by the State and to 50 per cent of the

net profits of the Trust in excess of the amount required to pay the minimum dividend. The remaining 50 per cent of the surplus profits will go to the State.

The amounts available for investment in the shares of the National Investment Trust, which will be defined later, are to be transferred to its credit by order of the investors, at any branch of approved members of the banking system, who will act as bankers and agents for the National Investment Trust in all banking transactions.

The shares are redeemable by the National Investment Trust at the option of the owners, at any time, at par plus accrued dividend from date of issue to date of surrender at the guaranteed rate of 3 per cent per annum, provided the proceeds are not utilised for the acquisition of existing securities (including mortgages) or left idle on deposit. The simple measures set out further on in this chapter will ensure the observance of these restrictions.

No account will be maintained by the National Investment Trust at the Bank of England, because the money the Trust handles must not be permitted in any way to affect the reserve position of the banking system. This would be bound to be the case if the National Investment Trust instructed the banking system to pay its credit balances over to the Bank of England, since this would involve a reduction in the balances of the banking system at the Bank of England which constitute part of the banking system's reserves. It is true that this would be rectified when the National Investment Trust paid out the money received for new financing, but receipts and expenditure of the National Investment Trust would not necessarily coincide and disturbance of the banking system might ensue.

As a first step, the large volume of bank deposits now constantly idle must be attracted into the orbit of the National Investment Trust. Upon the establishment of the New Order it will no longer be possible to leave funds on fixed deposit in the banking system, nor may any interest be paid on credit balances in banking accounts. The offer of inducements for a course prejudicial to the interests of the community is an absurdity.

Existing fixed deposits in the banking system will, upon expiry, be transferred to ordinary banking account in accordance with usual practice. The owner may voluntarily instruct the bank to transfer the balance to his credit at the National Investment Trust, who will, there-against, issue its deposit receipt. This is reconvertible into an ordinary bank balance at any time at the option of the holder, provided proceeds are not left idle or invested in existing securities or mortgages. Failing such voluntary transfer to the National Investment Trust the funds will automatically come under the control of the National Investment Trust through the operation of a provision concerning " normal " balances.

At the end of each quarter the amount by which any credit balance in current account in the banking system exceeds the " normal " will be transferred to the credit of the National Investment Trust in the bank concerned, in favour of the depositor. The latter thus becomes a depositor in the National Investment Trust and receives a deposit receipt as above indicated.

The " normal " will be a sum which bears a relation to the previous quarter's turnover corresponding to that which average daily balances in current account in the year preceding the establishment of the New Order bore to that year's turnover in the account, subject to an upward limit of 10 per cent. Supposing that proportion was 2 per cent then, any amount by which the balance in the account shown at the end of the quarter exceeds 8 per cent of the expired quarter's turnover will be transferred to the National Investment Trust.

It is probable that during the period of rehabilitation described in Chapter 22 a substantial part of this idle money will go into circulation against surrender of the deposit receipts. A further proportion will be transferred during that period to the National Estates[1] and disbursed by them to finance any expansion for which State aid is granted as indicated in Chapter 22. Securities would be received by the National Investment Trust for the money so provided.

[1] See Chapter 25.

Yet a further part would be utilised by the National Investment Trust to acquire from the banking system securities now held by the latter, thus making room for any likely expansion of self-liquidating loans of the banking system and preventing the forcing up of the long-term interest rate, otherwise invariably resorted to as we see at present. At the same time, these holdings would provide the National Investment Trust with an income, whilst the banking system would be amply compensated for the reduction of its interest revenue from securities by the discontinuance of interest payments on deposits. To the extent of the purchases of securities by the National Investment Trust from the banking system, bank deposits will automatically be cancelled. An ample margin of bank deposits will, however, be retained by the National Investment Trust to meet any surrenders of deposit receipts by owners as a result of further expansion in economic activity.

When the rehabilitation stage has been passed and the New Order has had time to pervade the working of the economic system, the deposit receipts will become convertible into shares of the National Investment Trust, thus assuring an income to the owners. By then it may be presumed that the flow of money amongst goods and services will have been established at a level at which it will thereafter be maintained. The volume of outstanding deposit receipts is likely then to be considerably less than the present volume of idle deposits, and against the bulk of them the National Investment Trust will be holding earning assets, so that it will be possible to meet the dividend on ordinary shares issued in exchange for deposit receipts. When that stage is reached all deposit receipts issued from time to time under the "normal" balance provision will become convertible into shares three months after date of issue.

No one will maintain accounts in more than one bank, though other classes of business may be transacted with any bank. If more than one account is carried with the same bank, inter-account transfers will be ignored in computing turnover.

Adequate precaution against hoarding of notes will be taken if required.

An exception to the rule that no interest will be paid on deposits may be made by Savings Banks, including the Post Office Savings Bank. Since accretion to the funds of such institutions will be directed into the National Investment Trust, no lasting diversion from the flow of current commodity money will be caused, and the Savings Bank will merely act as an intermediate link in the chain by which such savings are restored to the circuit flow by the National Investment Trust.

We now turn to the current operation of the National Investment Trust and the problem of investment.

Under the new order, funds derived from the following sources will be transferred to the control of the National Investment Trust, who will issue its shares there-against:

1. All surplus income of individuals available for investment in securities.
2. All current undistributed profit of enterprise which it is desired to invest in securities.
3. All other sums retained out of the price obtained for goods and services in so far as it is desired to invest these in securities. (Current additions to reserves, voluntary or necessary, hidden or disclosed, not utilised in the business.)
4. Current accretions to funds of life insurance companies and savings institutions not invested in houses. The other forms of reinvestment enterprise (Building Societies and mortgage companies, Investment Trust companies) will cease to invite funds from the public. A special régime outlined below will apply to approved institutions engaged in lending on mortgage, including building societies. The current undistributed profits of reinvestment enterprise are on the same footing as those of other concerns.

Since existing securities, as already stated, may not be bought save out of proceeds of existing securities by the seller, the only investments available, apart from the

National Investment Trust shares, are houses and land.

It is to be expected that not all sellers of existing securities will desire to reinvest proceeds in other existing ones. The National Investment Trust will purchase existing securities in so far as such proceeds are not so used. The general price level of existing securities should, therefore, not be affected, though changes in the price of individual securities will continue to occur.

Proceeds of sale of existing securities will be credited to the seller in a special " old " account in the banking system. All purchases of existing securities, other than by the National Investment Trust, must be settled by funds from " old account ". Balances in " old " account not used for purchase of existing securities are available for any other payments, except purchase of mortgages. If it is desired to invest in securities they must be transferred to the National Investment Trust against the latter's shares. Unutilised balances will automatically revert to the National Investment Trust, but in that case non-interest-bearing deposit receipts will first be issued by the latter which do not become convertible into shares until three months later. It is, therefore, in the interest of owners of unutilised balances to tender them voluntarily for investment in the shares of the National Investment Trust in order to receive immediate benefit of the guaranteed dividend.

Holders of existing securities, desirous of selling these with a view to acquiring other existing ones, may obtain temporary advances from the banking system pending sale of their holding, which will be pledged to the bank as collateral. It will be a condition that the advance shall be liquidated out of the proceeds within an agreed limited period, failing which the bank will itself dispose of the securities pledged, for the account of the borrower, to the National Investment Trust, thus permitting the advance to be extinguished. Speculation in existing securities with attendant credit inflation cannot therefore arise.

Since the funds utilised by the National Investment Trust in acquiring existing securities are derived from one of

the sources above indicated, it is important that they should be restored to circulation amongst goods and services.

This, as we shall see, will in fact inevitably be the case under the New Order, provided supply and demand in houses and land is strictly balanced. It will be the business of the National Investment Trust to ensure this equilibrium.

Proceeds of matured, redeemed, drawn, amortised and repaid debt, including mortgages, and of life insurance policies which have become claims or are surrendered, and of loans obtained from life insurance companies against policies, will not be credited to " old account ". Such payments will, in whole or in part, have been effected out of current income, profits or surplus revenue, and if existing securities could be bought with funds of that type it would tend to increase the volume of money circulating amongst securities to the detriment of the current flow of money amongst goods and services. To the extent that the payments are derived from pre-existing capital balances this will be reflected in a decline in the bank balances under control of the National Investment Trust and will thus automatically be taken into account in the volume of investment by the National Investment Trust. If the capital sums are not utilised by the recipients in goods and services, they will promptly revert to the National Investment Trust and increase the amount available for investment by the latter. In so far as proceeds of existing securities are used for capital payments above referred to, the funds must have been derived from current receipts of the National Investment Trust, since the latter provides the money required to absorb sales of existing securities in excess of purchases. If such funds are not re-spent on goods by the recipients they will be restored to the commodity flow upon reversion to the National Investment Trust, since it will be the task of the latter to re-spend upon investment representing goods and services all sums that, on balance, come into its hands.

Whilst the acquisition of houses and land will not be as rigidly insulated as investment in existing securities, certain

restrictions and supervision must be imposed. It is essential that the volume of bank balances which it is desired to invest in houses and land (other than those representing reinvestment of proceeds) shall equal the amount of proceeds which sellers wish to use otherwise. In other words supply and demand must be maintained in strict balance. Failing this, if demand exceeded supply, bank balances would be circulating amongst houses and land, driving up the value, and depleting the flow amongst goods and services. Even if pre-existing capital balances were utilised—and not current income or profits—this would reduce the volume of bank balances under the control of National Investment Trust and would diminish the amount the latter would consider itself entitled to invest in new financing.

Therefore, the National Mortgage Institute, which will act on behalf of the National Investment Trust in all business in houses and land, will serve as clearing-house for all payments connected with transactions in houses and land, and a record will be kept of all relevant data. In addition, it will maintain close contact with the trade associations concerned and arrange for all necessary information to be supplied to it which will permit it accurately to gauge the state of the property market, and to propose, if necessary, adjustments in the building programme of the Economic Council.

Acquisition of houses, old and new, will continue to be unrestricted, subject to the observance of the formalities in regard to payments, which may be made through any of the principal branches of the banking system for account of the National Mortgage Institute. As houses will be the only capital investment freely available, apart from the shares of the National Investment Trust, the possibility of speculative demand must be reckoned with. In that case the building of new houses, which would proceed on planned lines under the Economic Council, could, if required, be accelerated. Preference would be given to purchasers for occupation, and other purchasers rationed. To the extent that requirements of these latter cannot be satisfied they must accept

National Investment Trust shares. Should, on the other hand, demand for house property fall short of the offer, the National Investment Trust, through its subsidiary the National Mortgage Institute, could effect purchases to equalise the position, pending readjustment of building activity.

Provision in regard to the settlement of transactions in land through the National Mortgage Institute would be identical with those concerning buildings. Land may be acquired without restrictions only by sellers of other land out of proceeds of such sales. If the money with which it is desired to purchase land is derived by the intending purchaser from other sources—and the record of the National Mortgage Institute will establish this—then purchase will be permitted only for residential purposes, for farming by the purchaser, or for prompt erection of buildings. Fresh speculative purchases of land will thus be impossible. It is unlikely that, under these conditions, the demand for land would exceed supply, but, in any case, if it did, this would promptly be remedied through the operation of the new Inheritance Law, to which we shall refer in a subsequent chapter.

If, on the other hand, there is an excess of offer of land, the National Investment Trust may invest in land to the extent of the deficiency.

The granting of new mortgage loans and the purchase or replacement of existing ones will be concentrated with approved lending institutions specialising in this class of business, including building societies. They will cease to invite funds from the public, and in so far as repayments in respect of existing mortgages held by them are not sufficient to meet demand for mortgage loans, the National Mortgage Institute will supply the additional funds required. The Institute in turn obtains the money from the National Investment Trust out of the latter's current receipts, and it will issue there-against to the Trust 3 per cent mortgage bonds secured by the mortgages which the approved lending institutions will deposit as collateral.

The bulk of the net profits made by the approved

lending institutions with funds derived from the Institute will be payable to the latter and will revert as dividends to the parent concern, the National Investment Trust. In view of the monopoly which will be enjoyed by the mortgage lending institutions the National Mortgage Institute will, from time to time, determine the maximum rate of interest to be charged.

Existing holders of mortgages, other than approved mortgage lending institutions, will not be entitled to re-invest proceeds of mortgage repayments in other mortgages, and they are subject in regard to new investment to the same restrictions as other investors.

All payments in connection with mortgages, other than those held by approved lending institutions, must be made through the National Mortgage Institute. Approved mortgage lending institutions will supply the National Mortgage Institute at regular intervals with particulars concerning all repayments received on mortgages and all mortgage loans made.

In the preceding paragraphs we have dealt with forms of investment open to the public and we have indicated the position of the National Investment Trust in regard thereto. We now come to the principal function of the National Investment Trust.

All proposals for new financing for other than self-liquidating purposes, whether on behalf of domestic enterprise or of foreign seekers of capital, will be submitted to the Investment Board, with the exception, of course, of domestic schemes financed out of enterprisers' own resources. If approved, the funds will be supplied by the National Investment Trust out of its capital, by having bank balances under its control transferred to the credit of the interests requiring the capital. Before the financing can be considered by the National Investment Board, all domestic expansion of productive capacity must have the assent, in principle, of the Trade Association for the particular branch of economic activity. Membership in such associations is obligatory upon all engaged in enterprise of any description. Approval of new financing projects can be given by

the Trade Association only if the scheme comes within the framework of the planned economic requirements of the branch, co-ordinated with those of the nation as a whole, as determined by the Supreme Council.

The technical and financial background of each proposition will be investigated and all data submitted as if a public issue were contemplated. When the transaction is sanctioned by the National Investment Board, the National Investment Trust will pay over the sum agreed upon to the enterprise concerned, against delivery of the new securities created. If, pending such long-term financing, temporary advances are required for non-self-liquidating purposes, such advances will, under the New Order, no longer be obtainable from the banking system but only from the National Investment Trust, subject to the same condition as to prior assent by the Trade Association above indicated.

There will be no discrimination on the part of the National Investment Board on account of the smallness of any proposition. The £1000 required by the little entrepreneur will receive equal consideration with the £25 million scheme of the mammoth combine. In point of security, however, no precaution that experience or foresight can suggest will be neglected.

No securities on which the interest or dividend is not contingent upon earnings will be acceptable to the National Investment Trust in respect of new financing. Only income debentures, non-cumulative preferred, ordinary and deferred shares can, therefore, be created, from the establishment of the new order.

Proposals from foreign capital seekers, once sanctioned in principle by the National Investment Board, will be sifted and studied by the International Investment Trust and particulars prepared for submission to the Board as if a public issue were to be made. If finally approved the securities to be created will be received by the International Investment Trust and lodged as collateral for its own 3 per cent Bonds to be issued to the National Investment Trust, who supply the money and to whom any profit margin

automatically reverts as holder of the capital of the International Investment Trust. The foreign borrower will be credited in an account at the National Investment Trust with the proceeds of the securities sold to the International Investment Trust and will be entitled to utilise the funds in payment of goods acquired from makers in this country.

With a brief observation on hire purchase and non-self-liquidating credit in the banking system we shall have covered the main features of the circuit flow. After the establishment of the new order any increase in hire purchase credit will be supplied by the National Investment Trust, whose account in the banking system will be debited to the credit of the borrower, the bank acting solely as agent. No new money will thus be created. If a decrease occurs subsequently the repayment will be credited to the National Investment Trust.

Should the volume of such credit fall below the level at which it stood when the new order commenced, the National Investment Trust will replace the money thus withdrawn from circulation amongst goods. For this purpose it will utilise money representing former idle deposits transferred to it at the initiation of the new order, in additional financing, domestic or foreign.

The other type of non-self-liquidating bank credit—loans made in the past by the banking system for financing of capital assets—can only decrease and will, in due course, be extinguished under the new order, the place of the banking system being taken in that respect by the National Investment Trust as described above. As these bank loans diminish through repayment, the National Investment Trust will replace the money in the same way as in the case of hire purchase credit. Although the aggregate volume of money is reduced by the repayment there is thus no change on that score in the volume of money circulating amongst goods.

The following summary of balances transferred into and out of the control of the National Investment Trust may be found helpful :

A—Receipts of National Investment Trust and Outgoings during Rehabilitation Stage

Receipts	Payments
1. Transfer to National Investment Trust of idle bank deposits under "normal" balances provision. Non-interest-bearing deposit receipts will be issued by National Investment Trust against funds so transferred.	1. Payments to owners of deposit receipts surrendered with a view to utilisation of funds in enterprise, current expenditure, purchase of houses and land or fulfilment of obligations. This is likely to happen on a substantial scale during the period of rehabilitation of the National Economy sketched in Chapter 22.
	2. Payments on behalf of National Estates for Government-aided financing during rehabilitation period. Against these payments securities of the enterprises concerned, with appropriate guarantee by Government, will be lodged with National Investment Trust.
	3. Transfer to banks in payment of Government securities to be purchased from them to make room for self-liquidating credit expansion by banking system without forcing up long-term interest rate. This money will thus be cancelled.

A sufficient volume of idle bank deposits will be retained under the control of the National Investment Trust to provide an adequate margin against possible surrenders of deposit receipts by owners for purposes permissible under the New Order, and for any emergency financing by the National Investment Trust in unlikely case of slackening in economic activity.

[Table B

B—Current Receipts and Payments of National Investment Trust

Receipts	Payments
1. *All money which individuals desire to invest in securities out of current surplus income from whatever source derived.* This investment can only take the form of shares of the National Investment Trust.	1. *All domestic financing of new capital assets* except in so far as enterprisers finance assets of that type out of bank balances under their own control.*
2. *All current undistributed profit of enterprise and other sums included in the price obtained for current goods and services in so far as not re-spent on goods and services, buildings or land.* This item will not *prima facie* be ascertainable in its entirety from the accounts of enterprise, but it will be necessary to make a comparative analysis of the latest and the previous period's accounts. Holdings of National Investment Trust shares or deposit receipts will, under the new order, be separately shown in balance sheets.	2. *Through International Investment Trust: all foreign financing.**
3. *Accretions to funds of life insurance companies and savings banks, other than those included under* (2). These two types of reinvestment enterprise will continue to receive funds mainly (though not necessarily entirely) out of current income or profits of the members of the community. Investment Trusts and Building Societies will discontinue appealing to the public for funds.	3. *Funds required for increase in mortgage loans by approved lending institutions* (through National Mortgage Institute).
4. *Proceeds of existing securities in so far as sellers desire to acquire shares of the National Investment Trust.*	4. *Payments for existing securities acquired by National Investment Trust* to extent that sellers of existing securities do not reinvest in other existing securities.
5. *Through National Mortgage Institute, proceeds of land or buildings sold,* for its own account or for account of National Estates, to meet excess demand, if any.	5. *Payments for land or buildings acquired,* if any, to ensure equilibrium in supply and demand (through National Mortgage Institute).

* Securities will be received by National Investment Trust and International Investment Trust in exchange. Temporary financing pending the issue of securities to the National Investment Trust will likewise be carried out by the National Investment Trust.

Receipts (contd.)	Payments (contd.)
6. *Amounts repaid on balance by mortgagors to specialised mortgage lending institutions* in so far as funds had previously been supplied by National Investment Trust (through National Mortgage Institute).	6. *Payments to owners of National Investment Trust shares or deposit receipts against surrender of same.* The deposits thus transferred may be utilised by the owners to pay for goods and services (including new capital goods subject to approval of Trade Association) to acquire buildings or land and to meet obligations.
7. *Proceeds of matured, drawn, amortised, repaid, redeemed debentures, etc., and of repaid mortgages* (*not in the hands of specialised mortgage institutions*) *and capital payments received in respect of life insurance policies* in so far as not re-spent by recipients upon goods and services, buildings and land or on repayment of debt.	7. *Transfer to banking system of amount corresponding to increase, if any, in hire purchase credit* above level at introduction of new order.
8. *Through the banking system, amounts repaid in respect of hire purchase bank credit,* in so far as this was previously supplied by National Investment Trust. (In case hire purchase credit falls below level outstanding on establishment of new order, National Investment Trust will replace difference by additional financing out of idle deposits. It will do likewise in regard to decrease in existing non-self-liquidating bank credit).	8. *Transfer to Gold Settlement Fund account in banking system against Treasury bills taken up by National Investment Trust* (when Gold Settlement Fund on balance buys gold or foreign exchange).
9. *Through the banking system, quarterly, under the "normal" balances provision, any balances in excess of the normal proportion to turnover* (for instance, working capital temporarily not required; in the case of mortgage lending companies accretions to funds resulting from repayments carrying down level of mortgages below that outstanding on new order becoming operative). Non-interest-bearing deposit receipts will be issued against such sums which, if not meanwhile surrendered, are convertible into shares three months after the date of issue.	9. *Payment to Government* against Treasury bills issued to bridge temporary deficiency in Government revenue.
10. *Transfer from Gold Settlement Fund* account in banking system, against surrender by National Investment Trust of Treasury	10. *Payment to Government against securities representing fresh borrowing by Government* or consolidation of existing short-term debt,

RECEIPTS (contd.)	PAYMENTS (contd.)
bills held (when Gold Settlement Fund on balance sells gold or foreign exchange).*	in so far as conversion not accepted by holders.
11. *Repayment by Government*, out of excess revenue, of Treasury bills or other Government Debt previously taken up by National Investment Trust to bridge temporary deficiency in revenue, or for other purposes.	

* If the Treasury bills to be repaid out of proceeds of the gold and foreign exchange are not held by National Investment Trust there is, on balance, no direct change in the bank deposits under control of National Investment Trust. Buyers of the gold and foreign exchange are debited in account and holders of the Treasury bills credited. If, however, the proceeds of the bills are used to repay bank debt the National Investment Trust must correspondingly increase its financing to counteract contraction of the money flow amongst goods and services.

C—RECEIPTS AND OUTGOINGS OF NATIONAL MORTGAGE INSTITUTE AS SUBSIDIARY OF NATIONAL INVESTMENT TRUST AND AS CLEARING-HOUSE FOR TRANSACTIONS IN LAND, BUILDINGS AND MORTGAGES

RECEIPTS	PAYMENTS
1. Purchase money for land and buildings lodged by buyers other than National Investment Trust (as *per contra*).	1. Proceeds of buildings and land sold paid over to sellers (as *per contra*).
2. Purchase money for land and buildings lodged by National Investment Trust in case it buys for its own account.	2. Proceeds of buildings and land paid over to National Investment Trust in case the latter sells buildings or land for its own account or for account of the National Estates.
3. Repayments lodged by debtors on mortgages held by lenders other than approved mortgage lending institutions (as *per contra*).	3. To non-specialised lenders in respect of repayments lodged by debtors on mortgages (as *per contra*).
4. From National Investment Trust to meet increase in amount lent on mortgage by specialised institutions over level at establishment of new order (as *per contra*).	4. To specialised mortgage lending institutions to finance increase in mortgage loans over level at establishment of new order.
5. From specialised mortgage lending institutions, repayments on balance on mortgages granted with funds of National Investment Trust (as *per contra*).	5. To National Investment Trust, repayments lodged by specialised institutions in respect of mortgages financed out of funds of National Investment Trust (as *per contra*).

The arrangements outlined will have the effect of making the state of the bank balances under the control of the National Investment Trust reflect, with few exceptions, any important changes in the money flow amongst goods and services. Thus, the withdrawal from its control of bank balances through surrender of shares or deposit receipts by their owners will, in so far as the money does not revert to the National Investment Trust as a result of the " normal " balances provision, involve a reduction in the amount to be invested by the National Investment Trust. Provided only that equilibrium in supply and demand for houses and land is achieved, there is no other outlet than re-transfer to the control of the National Investment Trust for any bank balances withdrawn from that control but not spent upon goods (consumption or capital goods). If, on the other hand, they are spent upon goods, the turnover they originate will, broadly speaking, result in their remaining under the direct control of owners themselves as the " normal " balances provision operates in relation to turnover.

Even changes in the use made of those balances which, at the outset of the New Order, were left under the control of their owners would, if such changes involved an increase in the money circulating amongst goods, have their repercussions upon the volume of balances controlled by the National Investment Trust. The balances to be retained under control of the owners would increase in consequence of the increase in turnover and the balances under control of the National Investment Trust would decrease. The National Investment Trust would correspondingly reduce the amount to be spent by it in new financing.

The only exceptions to this automatic functioning of the index of bank balances controlled by the National Investment Trust are, firstly, the reduction in pre-existing finance credit in the banking system and the unlikely contingency of a fall in hire purchase bank credit below the level at which it stood at the commencement of the new order, and secondly, repayment of self-liquidating bank credit out of existing bank balances controlled by owners direct or by the National Investment Trust, instead of out

of proceeds of the goods underlying the credit. The first exception has been provided against as outlined in a preceding paragraph. The second will involve a decline in the total of bank balances. This may be reflected in reduction of directly owned or National Investment Trust-controlled bank balances, or both. In any case those controlled by National Investment Trust would be affected, for at the next "normal" balances-stocktaking, if balances directly owned had been used for repayment of credit, these would either show a deficiency against normal or the amount reverting to the National Investment Trust would be less than it would otherwise have been. Thus appearances would be deceptive. It would look as if the National Investment Trust had less available for investment than it ought to have. Hence it will be necessary closely to correlate movements in self-liquidating bank loans with stocks of unsold merchandise, for the goods which the repaid loans served to finance will not have been absorbed. If self-liquidating bank loans show a decline without corresponding decline in unsold stocks of goods, or possibly with a movement of stocks in the opposite direction, it would point to repayments out of funds other than proceeds of the goods. Such discrepancies would then be compensated by financing of new capital assets out of old balances under the control of the National Investment Trust. In other words the National Investment Trust would invest more than the state of the current movements in controlled bank balances warranted. Before long, however, the goods unsold would have been absorbed out of the new financing, and the balances previously used by their owners to repay credit would be restored. Whilst the total volume of money would not be greater than it was after repayment of the credit, the amount circulating amongst goods will throughout have been maintained at its proper level. In this instance, then, and to the extent of the discrepancy between bank loans and stocks of goods, the National Investment Trust had to make an exception and not regard the bank balances withdrawn from its control as having been spent on goods.

Incidentally it will be noted that under the system de-

veloped in this chapter the repercussions of unproductive Government borrowing would be directly and palpably prejudicial to the national welfare, whereas, under the present order, the true character of such transactions is concealed.

Since there would not, and could not be, unemployment in the community which we are envisaging, the creation of non-productive assets for Government account would necessitate curtailment of work on other goods. Nor would it be a question of available labour alone. The National Investment Trust being the only source of non-self-liquidating loans, would supply the Government with the funds needed, and to that extent its resources available for new productive financing at home and abroad (items 1 and 2 on the payments side of the Statement of Current Receipts and Payments) would be depleted. Prospective improvement in the standard of living is thus in the same degree thwarted. At the same time the quality of the holdings underlying the shares of the National Investment Trust is deteriorated by admixture of Government Bonds having only assets destined to destruction behind them, in the place of securities based upon tangible productive assets at home, or upon valid promises by foreign borrowers to send us annually goods required by us.

The composition of the National Investment Board is of vital importance. Not only will it administer an ever-growing volume of assets resulting from the savings of the living generation at any time, but it will be called upon to exercise supervision on behalf of the National Estates over the mass of assets which, through inheritance, will become vested in the latter as time goes on and which will constitute the patrimony of the nation.

It will be upon the wisdom, foresight, enterprise and judgment exercised by the Board under the guiding lines of policy to be established for the country as a whole by the Economic Council, that the welfare of the State will in large measure depend.

Its members, therefore, must be thoroughly representative of the leading branches of economic activity in the

country, with a sprinkling of members nominated by Government, the Economic Council and the National Estates.

The Board will direct the work of the National Investment Trust and its two subsidiaries. These latter will each have a small Board nominated by the National Investment Board.

The management of the affairs of the three concerns in every one of their departments will be entrusted to experts in the sphere of business concerned. Their combined experience will extend not merely over the entire field of national affairs but it is important that there should be amongst them men fully versed in the economic life and problems of foreign countries whose Governments or nationals may be expected, sooner or later, to seek long-term capital in this country. As we know, such financing if approved would, under the New Order, have to be availed of in the form of goods made here.

The Board will delegate to small committees, drawn from amongst its members, the examination of all proposals that come before it. The committees may engage the services of outside experts, including the issuing houses, to investigate and report on any project.

In conclusion I submit a brief outline of the cumulative effect of the measures described.

With the minimum of disturbance or of interference with the normal conduct of the money mechanism, but with complete effectiveness, the New Order will ensure that any funds on balance withdrawn from the circuit flow of money disseminated in the production and distribution of goods and services, and indispensable to the absorption of the same, shall be promptly and unfailingly restored to the circuit, at a pace consistent with maximum productive capacity. As the New Order will operate in a society in which economic activity will be estimated in advance, planned and constantly adjusted to changing circumstances, the new capital assets that will be acquired will be such as are expected to be most conducive to prospective economic well-being. No longer will the unco-ordinated de-

cisions of individual enterprisers be able to override the interest of the community.

At the outset, the old idle deposits will be brought into play in the rehabilitation stage (Chapter 22). A part, by being used to relieve the banking system of some of its long-term securities, will make room for expansion in genuine trade credit. A further part will be utilised by its owners to finance the increased interchanges that will result from the rehabilitation process. In due course, when economic activity has attained the maximum level consistent with the full employment of the productive forces available in the country, the system of centralisation of investment will be put into operation. All the funds which the community can afford to invest in new capital assets, over and above those directly invested in by enterprisers or through purchase of new houses, will be made available through the instrumentality of the National Investment Trust on terms which, by their nature, can never constitute a burden to enterprise.

Over-investment or under-investment, now governed by the haphazard of chaotic money economics, will be a thing of the past. The reform of the banking system and of the Bank of England, to be dealt with in the next chapter, will once and for all remove the sinister power to raise the cost of long-term capital and, by the deterrent effect of this trend upon industry, to disrupt the interchange of goods.

Current financial history affords an illustration of the exercise of that power, with the result that the long-term interest rate has, so far, been forced up by ½ per cent, with corresponding increase in the cost of fresh borrowing. It is not so much the actual level of interest rates as the fear of a rise which destroys the desire to invest. Whilst, at the present juncture, the effects of this policy are to some extent offset by the rearmament programme since capital goods construction is bound to continue while Government spending lasts, the attainment of higher prosperity is retarded and the foundation laid for earlier reaction than would otherwise be the case.

Under the New Order, neither expansion nor contraction of the owned assets of the banking system will be permitted. So-called bank policy will be a thing of the past.

To the banking system will fall the duty to provide in any necessary quantity, and cheaply, all the self-liquidating credit required to meet the current needs of planned economic activity at its highest pitch. Only variations in the volume of money arising from the incidence of self-liquidating trade and personal requirements can occur. (The variations in pre-existing volume of non-self-liquidating and hire purchase credit will be compensated by National Investment Trust.)

Speculation in securities, commodities, houses and land will cease to be practicable, without penal provisions or irksome formalities.

The best conceivable security will be at the disposal of investors, the shares of the greatest investment trust company in the world, the National Investment Trust. Not only do they afford the widest distribution over securities to be created by every variety of enterprise, against tangible assets, as well as over mortgages, houses and land, and existing securities, but they are safe from depreciation, represent cash at any time, and carry a reasonable minimum return, guaranteed by the whole of the resources of the nation, with every prospect of an additional dividend. To an ever-increasing extent members of the community will become interested in these shares, either as direct investors, or indirectly as depositors in savings banks, holders of shares in and policies of insurance companies, and as shareholders in trust companies. Through the change in inheritance law, which will be effected under the New Order as described in a subsequent chapter, the bulk of the nation's assets will in due time revert to the country, and, as a growing proportion will consist in shares of the National Investment Trust, all members of the community will have a stake in its affairs. The New Order will provide the way for the gradual transfer of ownership of all permanent assets in the country to the nation on purely constructive lines and fully consistent with the greater efficiency and happiness of

the individual, whilst retaining all that is admirable and desirable of the capitalist structure. This result can, however, be attained only under capitalism imbued with a new spirit, as I have pointed out before.

The future needs for enhanced imports of raw materials, which will be associated with the growth of economic activity, and with the constantly increasing material well-being of the people, will be adequately safeguarded. They will be met out of interest and dividends on capital supplied to solvent foreign interests in the form of goods through the National Investment Trust's subsidiary, the International Investment Trust. Carefully prepared, and constantly supervised by experts, such transactions will be carried out with full regard to the ability of the borrower to provide the additional raw materials, etc., required by us, or, *vice versa*, to our ability to absorb the additional imports which the borrower can provide in settlement of interest and redemption. Thus the material well-being, both of the borrower's country and our own, can only be enhanced by such operations.

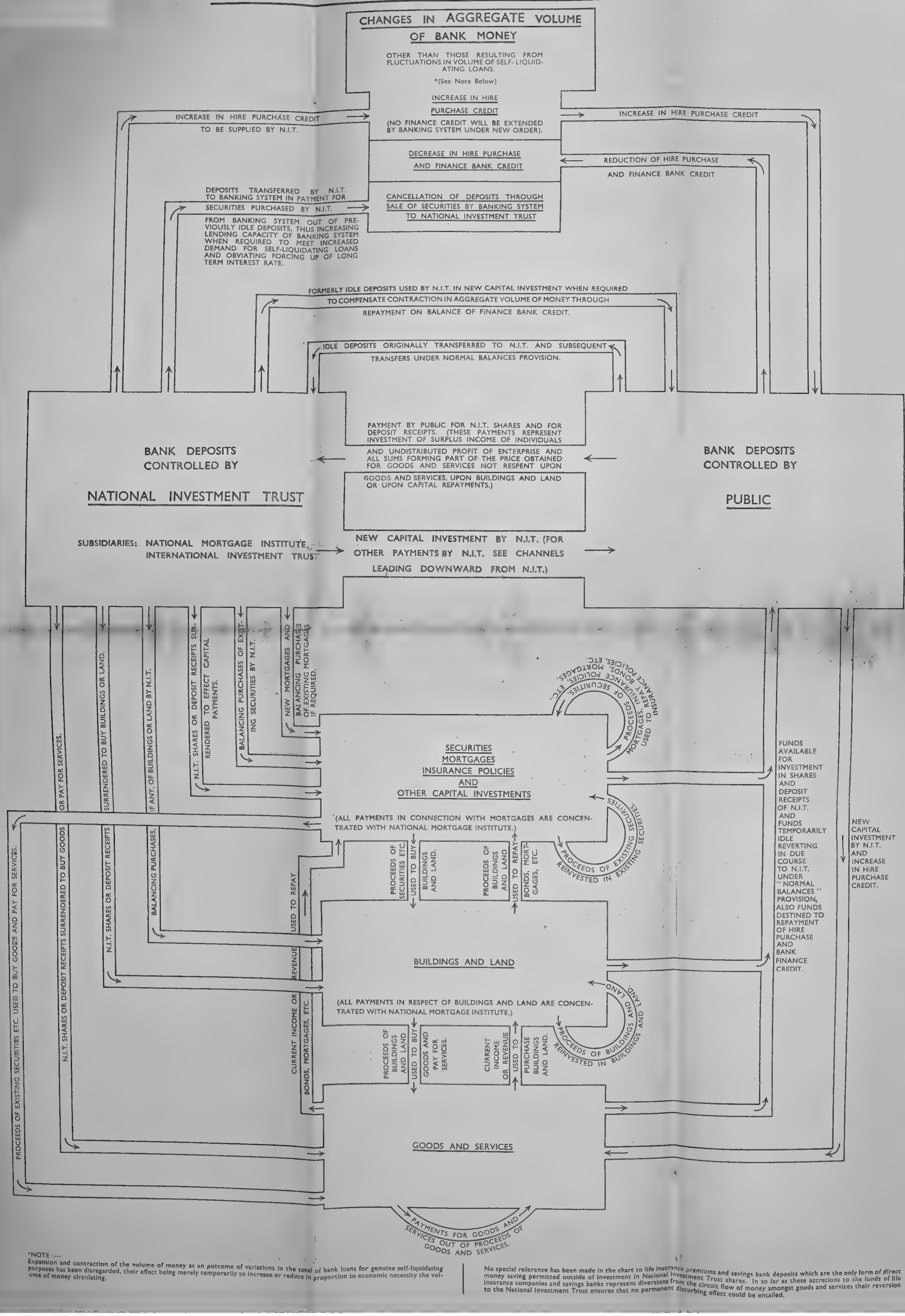
It need not be thought that the limitation of investment to the single security with nation-wide assets behind it, *i.e.* the shares of the National Investment Trust, will render the financial experts and issuing houses superfluous. There will be room, in the numerous sections of the National Investment Trust and its subsidiaries, for as many as are available. The country's affairs will require not less but more expert investigation and supervision. The issuing houses will be required to prepare all foreign proposals and any others that may come to them through connections, in consideration of a fee to be paid them by the National or International Investment Trust. Only the Stock Exchange will decrease in importance through the fact that no fresh securities will be issued to the public, and that to an increasing extent, through the restriction upon acquisition of existing securities, the latter will be held in institutional hands, including the National Investment Trust. There will, of course, continue to be a volume of exchanges from one existing security into another, but this may not be

sufficient to maintain the existing number of members and their staffs. There can be no doubt, however, that in a planned society, in which every talent will be utilised to the best advantage of the community as a whole on the basis of true equality, as outlined in a later chapter, there will be numerous openings for men of character in the direction of the ever-growing number of enterprises in which the National Investment Trust and, through inheritance, the country will become financially interested.

For greater clarity I append a chart showing the circuit flow of money available for investment, centralised with and redirected through the National Investment Trust.

By making the circuit flow a true and continuous one on the lines indicated it is not only practicable to eliminate the trade cycle in so far as man's dealings with money are responsible for its incidence, but it will become possible largely to insulate the country against the effects of cyclical movements elsewhere. Indispensable towards that end is the fulfilment of the following conditions : the breaking of the tyranny of gold, the balancing of our international balance of payments, the reform of the banking system, and the planning of economic activity.

CIRCUIT FLOW OF MONEY UNDER THE NEW ORDER



*NOTE :—
Expansion and contraction of the volume of money as an outcome of variations in the total of bank loans for genuine self-liquidating purposes has been disregarded, their effect being merely temporarily to increase or reduce in proportion to economic necessity the volume of money circulating.

No special reference has been made in the chart to life insurance premiums and savings bank deposits which are the only form of direct money saving permitted outside of investment in National Investment Trust shares. In so far as these accretions to the funds of life insurance companies and savings banks represent diversions from the circuit flow of money amongst goods and services their reversion to the National Investment Trust ensures that no permanent disturbing effect could be entailed.

Chapter 25

THE REFORM OF THE BANK OF ENGLAND AND OF THE BANKING SYSTEM

The New Order changes nothing merely from political motives. Its sole objective is the extermination of the malignant growths which the present system fosters and which have brought the world to its present disastrous plight. If not removed, they will inexorably overwhelm and strangle what remains of vigorous and prolific economic life, and of all moral and spiritual values of human existence, leaving but the mockery of rank despotism and degradation of the human spirit no longer recognisable as God's projection on this earth.

So far as our financial system is concerned, the aim of reform is twofold. Firstly, the sinister rule of gold must once and for all be abrogated, and our credit structure divorced from its sphere of influence, which henceforth is solely to be the settlement of international accounts. Secondly, the reserves of the banking system must be freed from dependence upon the discretion of the Central Banking authorities. The community must be assured at all times of the satisfaction, through the banking system, of all genuine self-liquidating credit requirements at uniform and low cost. No longer must the spectre of depression be permitted to haunt us as the predestined sequel to every economic recovery, through the disintegrating influences released by the forcing up of the long-term interest rate on the part of the banking system, hitherto inseparably associated with periods of expansion and progress.

One of the greatest obstacles to enlightenment of the community in matters financial, and a factor which must retard reform, are the references of bankers and financial journalists to increase in the cost of money, in times of greater trade activity, as a development both inevitable and

salutary. Comparison with pre-War policies in support of this view is completely deceptive, if only for the reason that our position now, both financially and economically, is in no single aspect assimilable to that ruling in those days. "Attracting" deposits to the banking system by offering higher interest rates is still seriously put forward as the natural and desirable course where money is scarce. A "policy" of that character ignores the fact that, hoarding apart, there are no deposits which the banking system does not already have. There is no other way under the present system to "attract" additional deposits than to "create" them through the purchase of securities or the granting of additional loans by the banking system. As additional deposits mean additional liabilities, and as cash reserves must bear a reasonable proportion to liabilities, it is to an increase in cash reserves that the banking system must look for the ability to "attract" (create) deposits, and this increase in reserves is dependent upon the discretion of the Central Banking authorities, who, by withholding additional credit, can render all efforts to "attract" deposits nugatory. In plain language, any rise in the cost of short-term money is nothing but a condition deliberately created, or permitted to arise, by the Central Banking authorities in their capacity as the ultimate source of the reserves of the banking system.

So long as gold is the basis of the credit structure, and that same gold is subject to being called upon for the settlement of unbalanced, uncontrolled and unplanned accounts resulting from international transactions, it may be pleaded that the negative "policy" just referred to, of withholding an indispensable increase in reserves, is inspired by caution. The effect, however, as we have repeatedly demonstrated, is to impose upon the banking system the necessity of refraining from increasing their liabilities.

When, in such circumstances, genuine trade requirements for self-liquidating credit render it incumbent upon the banking system to supply enterprise with additional deposits as the counterpart of new loans, it has no option

but to dispose of a corresponding volume of other assets. An equivalent amount of liabilities is thus cancelled and on balance the aggregate of the banking system's deposits is kept within the former level. The only assets available for that purpose on a sufficient scale are long-term securities, as the more liquid types, *i.e.* bills of exchange and money market loans, cannot be reduced to any important extent. By the depressing effect upon the price level of fixed interest-bearing and, in fact, of all securities, consequent upon the banking system's sales, the long-term rate of interest is inexorably, even if gradually, impelled upwards, with devastating consequences frequently referred to in this book.

It is time a clean sweep were made of this nefarious system. It is time that the public were placed in a position to appreciate at their true value the statements, from whatever source, that " increased deposits in the banks were *invested* in this or that type of assets ", or that a " drop in deposits necessitated the sale or contraction of one category or another ". This may appeal more to the conceptions which a public, uninstructed in the intricacies of finance, would naturally form of deposits, and which, in fact, is inherent in the significance of the word itself, but it is not in accordance with reality. " Deposits ", with the exception of actual currency, are bank money created by the banking system itself—indeed, against valid assets—and kept outstanding by the willingness of the community to use it as a means of settlement of accounts. Any increase in " deposits "—again with the exception of currency—is the result of action by the banking system, in acquiring assets for its own account or granting new loans, or both. Any decline in deposits is due to repayment of loans by the public, or sale of assets by the banking system, or both. Expansion of deposits can be countenanced by the banking system only in so far as their reserves permit, and those latter are governed by the credit policy of the Bank of England, in turn determined in part by gold, but in the main by its own discretion. All this has been explained and emphasised in earlier chapters, but so vital is the issue that I have dwelt on it once more.

Once and for all, then, the measures to be taken must deprive the Central Banking authorities and the banking system of the power to vary the long-term rate of interest. The duty must be imposed upon the banks to supply all current commercial requirements that fall within the scope of the maximum economic activity—planned and co-ordinated—of which the community is capable. We have already referred to some of these measures in dealing with the " new international gold standard " and with the centralisation of investment under the New Order. For the sake of completeness, however, they are reiterated in this survey.

The Bank of England's gold holding will be revalued at a figure somewhat below current market price, so as to leave some margin for a decline in the price of gold.

All but £100 millions (*i.e.* a little over £60 millions at present valuation) will be transferred to the Gold Settlement Fund. The place of the gold transferred as cover for notes issued will be taken by Government securities.

The Issue and Banking Departments of the Bank of England will be merged, as henceforth there will be no need for the segregation. This will permit of a reduction of the enhanced total of Government securities by the amount of notes now held in the Banking Department, since the Bank of England will no longer show its own notes held by itself as outstanding.

The Bank of England will no longer keep any accounts other than those of the Government and of approved members of the banking system, that is, all such banks as will be approved for accepting deposits from the public. Existing accounts not coming within these categories will be transferred to the banking system. The choice of bank will be left to the customer. If such transfer should result in any decrease, on balance, in the reserves of the banking system, it will, if necessary, be made good by the Bank of England purchasing to that extent securities from the banking system. The Bank of England will no longer make any loans, except to members of the banking system. Tem-

porary advances to the Government will be centralised with the National Investment Trust.

Neither the Bank of England nor the banking system will be authorised to buy or sell securities in the market. The Bank of England will no longer buy Treasury bills or other short-term paper in the market. Its function will be confined to the keeping of the Government's banking account and to acting as a rediscounting bank for the banking system.

In return for the curtailment of the banking system's prerogatives, it will be given the right to call upon the Bank of England for advances against practically the entire range of its assets, or to dispose to the Bank of England of the assets owned by it. On the other hand, the banking system will be under obligation to supply all genuine self-liquidating credit required by the community and coming within the planned activities of the country. Speculative credit may not be granted, nor any credit of a financial character. " Hatry " swindles and " pepper " ramps will not thrive under the New Order.

In order to make the rediscounting facilities to be afforded the banking system at the Bank of England effective, the repledging to the Bank of England by the banking system of collateral lodged by customers as security for loans will be permitted. Any collateral so repledged will remain in the custody of the bank concerned, who will hold it on behalf of the Bank of England, so long as any advance made by the Bank of England to the bank is outstanding upon it. Such advance must be repaid to the Bank of England by the bank concerned immediately the client repays, and the collateral is then released from any lien by the Bank of England.

The banking system will have power to call upon its customers at any time to furnish promissory notes in respect of advances made, in order to facilitate rediscounting at the Bank of England. It is not anticipated that use will be made by the banking system of facilities for the mobilisation of its loans and advances, as it owns a sufficient volume of assets available for sale to the Bank of England, or as security for

advances from the latter, to meet any conceivable contingency.

It must be remembered, moreover, that the National Investment Trust, as we have seen in the previous chapter, will be placed in the position of taking over a substantial portion of the securities of the banking system, with corresponding reduction in its deposits, which should enable the banking system, without further recourse to the Bank of England, to meet any likely demand for self-liquidating credit.

In practice, nothing short of a general " run " on the banking system could occasion demand for currency upon the banking system involving recourse to the rediscounting facilities at the Bank of England to the extent of more than a fraction of its security holdings. Even in a run, the mere knowledge that currency is obtainable to any required extent will eliminate the normal incentive to convert deposits into currency. In any case, powers will be taken by the Government to make hoarding of notes an expensive luxury. The obligation to maintain minimum balances frequently stipulated by the banking system in the case of active accounts or where borrowing facilities are enjoyed, the necessity to keep adequate provision for current turnover and the fact that a large volume of deposits will be transferred to and remain permanently under the control of the National Investment Trust, will in any case limit the opportunities for hoarding.

The Bank of England's note issuing privilege will be modified. It will still be authorised to issue notes against gold, but it is unlikely that it will be called upon to do so. In any case, the price at which it may buy will not be fixed in the law but will from time to time be decided upon by the Treasury.

On the other hand, it will issue notes, but to the banking system only, against a range of assets corresponding to those held by the banks. The banking system would, as of right, be entitled to obtain advances from the Bank of England against assets belonging to any of the groups specified in the law. Assets in certain groups may be sold

to the Bank of England. Credit may be taken for the amount of the advance, or for the proceeds of sale, in the account of the borrowing or selling bank at the Bank of England, or any part of the funds may be withdrawn in notes as may be required. Thus, the banking system will be equipped to face any demands upon it and no panic could shake it. The only contraction of deposits possible would be such as resulted from repayment of loans by borrowers.

In order to enable the banking system to satisfy itself that demands for commercial credit come within the scope of the planned activities of the country, customers seeking credit will submit to their bankers the confirmatory advice from their Trade Associations indicating the quota allotted to them in the global volume of trade which the members of the Association are expected to handle. Subsequent adjustments will be notified to the banking system by the Trade Associations.

The general guidance afforded by this information will, however, not absolve the banking system from the duty of seeing that the customary safeguards are observed in the financing of such operations and that adequate security is afforded by the customer. This is the more indispensable as every transaction may, in case of emergency, represent potential collateral for credit to be obtained by the banking system from the Bank of England.

Any increase in hire purchase credit over the level at which it stood upon establishment of the new order, will be periodically debited to the account of the National Investment Trust and credited to an internal account, " hire purchase credit ". Should there be a decrease during any period, an equivalent sum will be credited to the National Investment Trust and debited to the hire purchase account.

No fresh credit for construction purposes may be granted by the banking system. This type of credit will belong to the province of the National Investment Trust. Temporary credit against existing securities for the purpose of acquiring other existing securities may be granted, proceeds of such loans to be credited to " old " account. Credit of this type is necessary in order to maintain an

adequate supply of funds to facilitate sale of existing securities, in view of the restrictions that will apply to their acquisition. The prompt liquidation of such temporary loans has been provided for as outlined in the previous chapter.

Self-liquidating commercial loans may not be called in nor may renewal be refused if the nature of the transaction renders extension inevitable. In fact, under the New Order there can be no inducement for the banking system to decline accommodation which conforms to the conditions laid down. If the affairs of any debtor give rise to misgivings as to his solvency, steps are to be taken to place them under the supervision of representatives of the bank and of the trade association to which the debtor belongs. If it is found impracticable to arrange for profitable continuance or for the absorption of the business, its orderly liquidation will be carried out. It will be part of the task of the liquidators to assist those previously actively connected with the business to find other employment. In a planned society this should not present insuperable difficulties.

As explained in the previous chapter, fixed deposits will no longer be accepted by the banking system. Existing ones at maturity will be transferred to ordinary account, and under the " normal balances " provision any excess balances from time to time will revert to the control of the National Investment Trust on behalf of the depositor concerned. There will, in fact, be a constant movement of transfers between the deposits controlled by owners direct and those under the control of the National Investment Trust.

No interest may be paid by the banking system on any credit balances.

No one may carry accounts in more than one bank, but there is no restriction upon the number of accounts which anyone may carry in that one bank.

The gold remaining in the Bank of England will serve no other purpose than that of an emergency reserve for settlement of balances in the international payments account. It is never likely to be called upon, having regard to the full provision to be made through the Gold Settle-

ment Fund, as described in the chapter on the New International Gold Standard. If, nevertheless, gold out of the emergency reserve should have to be withdrawn, it would be replaced by Government securities so that such withdrawal could have no effect upon the domestic credit structure. If, and this is more likely, the Gold Settlement Fund should consider its gold and foreign exchange holdings more than ample to meet any likely emergency and should not desire to invest the excess abroad at that time, gold may be transferred to the Bank of England against corresponding cancellation of Government securities held by the Bank of England. The Treasury bills which the Gold Settlement Fund issues to finance the acquisition of gold or foreign exchange will be purchased by the National Investment Trust. The money so disbursed will be transferred by order of the Gold Settlement Fund to the credit of the sellers of the gold or foreign exchange. Except in so far as it is used in goods and gives rise to additional turnover, justifying larger bank balances under direct control of owners, the money will revert to the National Investment Trust under the " normal " balances provision. When the purchases of gold and foreign exchange represent immigration of foreign capital it is unlikely that the foreign owners will utilise proceeds in goods, and in that case they will become holders of deposit receipts or of shares in the National Investment Trust and the position of the National Investment Trust remains unchanged. The volume of its funds available for financing remains unaffected.

When gold or foreign exchange are sold on balance by the Gold Settlement Fund the buyers' accounts in the banking system will be debited. On the other hand, the account of the National Investment Trust will be credited, by order of the Gold Settlement Fund, against surrender of a corresponding amount of Treasury bills held by the National Investment Trust. Gold or foreign exchange sales on any scale cannot arise under the New Order except to meet repatriation of foreign-owned funds. As these are likely, as above explained, to come under control of the National Investment Trust, it will be necessary for the

foreign interests desiring to repatriate them first to surrender their deposit receipts or shares of the National Investment Trust in order to regain control of their deposits. Hence, the transfer of bank balances by order of the Gold Settlement Fund to the National Investment Trust, in repayment of Treasury bills, is likely merely to cancel out the withdrawal of a corresponding amount of balances from the control of the National Investment Trust by the foreign holders of shares or deposit receipts in National Investment Trust.

If the foreign interests concerned had previously been utilising their funds in enterprise, instead of leaving them under the control of the National Investment Trust, withdrawal of this money from use in enterprise with a view to repatriation will cause the volume of bank balances, under direct control of owners and circulating amongst goods, to diminish, and that under control of the National Investment Trust to increase. The latter will then automatically re-spend the funds in financing enterprise.

The banking system, as explained in Chapter 23, on the New International Gold Standard, will deal in foreign exchange solely as agent for the Gold Settlement Fund. Without going into detail of the book entries to be passed, it will be clear that both expansion and contraction of gold and foreign exchange holdings of the Gold Settlement Fund will cease to have any effect upon the total volume of bank balances or upon that circulating amongst goods and services.

Any increase in the volume of Treasury bills, to finance temporary excess expenditure by the Government over revenue, will likewise be taken up by the National Investment Trust. This means that bank balances under control of the National Investment Trust decrease and are distributed by the Government in payment for goods and services, interest, etc. Automatically the National Investment Trust will spend correspondingly less on new financing, so that undue stimulation of the flow of money amongst goods and services, as a result of transitory over-spending by the Government, will be prevented. When the ingathering of revenue enables the Government to repay the additional

Treasury bills, the National Investment Trust will use the proceeds to increase its previously retarded investment programme.

Similar co-ordination will be required when Government floating debt is consolidated by the issue of a long-term loan, though the problem is of somewhat different character. In practice, the floating debt, such as Treasury bills, is looked upon as a short-term self-liquidating debt, but in reality, apart from bills issued to bridge the time lag between expenditure and the receipt of revenue, these Treasury bills are nothing but long-term debt in disguise. They are, however, differently held from long-term debt, a considerable proportion being owned by the money market and pledged as security for day-to-day loans from the banking system.

It is likely that a consolidation of such floating debt would result in reduction of these money market loans. The long-term security would not be as readily acceptable, either as an investment to the existing owners of Treasury bills and of other short-term debt, or as collateral security for day-to-day loans by the banks. Hence, to the extent that proceeds of Treasury bills to be repaid are not reinvested in the long-term loan, money has to be found from other quarters.

The Bank of England and the banking system, under the New Order, will not be permitted to purchase additional Government securities, nor could the banking system make new loans to enable the public to subscribe except pending sale of other existing securities by their holders. The consolidation loan would be looked upon as an existing security as it would merely be taking the place of one and does not constitute fresh borrowing on the part of the Government. If it did, it could only be purchased by the National Investment Trust. It is to be borne in mind, however, as explained in the previous chapter, that funds required to buy existing securities, sold by their owners to take up the consolidation loan, will ultimately be derived from the National Investment Trust in its capacity of guardian of equilibrium between supply and demand in the security market.

Any balance of the consolidation loan not taken out of proceeds of existing securities or in exchange for the short-term debt to be consolidated will be taken by the National Investment Trust, who thus, in effect, directly or indirectly, furnishes the whole of the money required to take up that part of the consolidation loan not accepted in exchange for the short-term Government debt to be repaid. It would clearly not be justifiable that the financing programme of the National Investment Trust should have to be correspondingly reduced, except in so far as proceeds of the repaid portion of the short-term debt should have been utilised by recipients in enterprise or in consumption of goods or payment for services. To this extent the money will not return under the control of the National Investment Trust, because the larger turnover occasioned in goods will justify larger balances being retained under direct control of owners. The rest of the money expended by the National Investment Trust should automatically return, with the exception, however, of any sums utilised by holders of redeemed short-term debt to pay off bank loans. To the extent, then, that bank loans are reduced out of proceeds of the short-term debt, the National Investment Trust will disregard the reduction in the balances under its control and utilise old existing balances under its control for financing purposes, thus counteracting the reduction in the amount available for investment, which would otherwise have resulted.

Thus the reduction in volume of money arising from repayment of loans by the money market out of proceeds of a consolidation loan would remain without effect either upon money rates or upon any feature of the circuit flow of money.

I will now briefly outline the organisation of the financial system under the New Order. The supreme authority, under the Chancellor of the Exchequer, in the financial sphere will be the Banking Board. It will consist of the Governor of the Bank of England, representatives of the Clearing Banks and of the finance houses, leaders in the industrial and business world elected by the Trade Associations, representatives of

the employers and of labour, and a professional economist, and finally nominees of the Chancellor of the Exchequer. The Professor in economics will be selected from a panel composed of nominees of the universities, each university naming one candidate. Copies of the panel are then circulated to the universities, who will indicate their first and second choices amongst the nominees other than their own. The economist attracting the greatest number of first choices joins the Banking Board. In the unlikely event that no one should receive more than one first choice, the candidate receiving the most second choice ballots will be elected.

The functions of the Board will not be executive, but it will operate as adjudicator in any conflict on matters of policy and conduct between the elements composing the financial system. It will also be the liaison between the latter and the other bodies having similar tasks in other spheres of the economic organisation of the country.

The Bank of England will no longer continue as a private institution, though its management will be removed from political interference. It is incongruous that an institution enjoying a position of unique privilege should be subject to a Board of Directors which owes no responsibility to the community, however much the integrity of its members and the calibre of the officials would place it above the suspicion of selfish aims. Moreover, it is essential that full co-ordination of its activities and direction with the requirements of a planned society shall be assured, not merely as a matter of goodwill and complaisance, but as an obligation which the community is entitled to impose. In fact, its power for good or evil under the New Order will be negligible, and it will by statute be prohibited from lending direct to the Government.

Shareholders will be offered the opportunity of exchanging their holdings into Government Bonds on the basis of average yield on market price of the shares during the previous five years. Alternatively, shareholders may demand cash on the same basis. The proceeds will be considered "old" money and may be used for acquisition of other

existing securities. The funds required to buy out the shareholders who do not exchange will be supplied by the National Investment Trust against the Bonds to be issued by the Government.

Again, the bank balances transferred out of the control of the National Investment Trust, as in the case of the consolidation loan, will not be permitted to affect the amount available for new financing. In so far as shareholders of the Bank of England elect to take cash, that is, to the extent that funds are derived from the National Investment Trust, there are only two uses open to the recipients which will result in the money not being retransferred to the National Investment Trust. One, employment in enterprise or current goods, involves higher balances being kept under direct control of owners under the "normal" balances provision, and this automatically reduces the volume of money to be spent in financing by the National Investment Trust. The other, repayment of bank loans, necessitates a non-automatic adjustment in the volume of investment by the National Investment Trust and must be compensated, as in the case of the consolidation loan above referred to, by utilisation of old existing balances under control of the National Investment Trust in new financing.

The shares of the Bank of England will be held by the National Estates, the body in which, in due course, all capital assets of the nation, except those owned by living generations, will be vested. We shall hear more about this body when we deal with Inheritance under the New Order. Suffice it here to say that it will be a public body whose directors will be in part nominated and in part elected from amongst representative groups.

The Governor of the Bank of England, who shall be a professional banker, will be appointed by the Board of the National Estates in its capacity as the sole shareholder on behalf of the community. The appointment is subject to confirmation by the Chancellor of the Exchequer and Cabinet approval. Its duration will be for a substantial period of years, renewable by mutual agreement. The other members of the Board, which should be limited in number,

will be appointed by the National Estates Board from a panel jointly submitted by the Economic Council and the Banking Board, and representative of the chief branches of economic activity in the country, including the Clearing Banks. A proportion of the directors of the Bank of England will retire in rotation at regular intervals. The Governor shall not be removable except on the recommendation of the Board of the Bank of England itself to the Board of the National Estates and after full enquiry and confirmation by the latter, and subject to the sanction of the Chancellor of the Exchequer and the Cabinet. If there should be a disagreement at any stage of the removal proceedings, a court of enquiry shall be appointed by all the parties concerned and its decision shall be final.

I leave to a later chapter a more comprehensive outline of the organisation of a community which will, in fact, become a nation of trustees. The aim, throughout, is to cause as little interference with initiative and enterprise as is consistent with the radical removal of the cancers that undermine and, in time, must destroy the economic vitality of the nation and, with it, liberty and social order. Where our obligations to our fellow-members of the community are truly recognised, the duties and restrictions involved in trusteeship will be readily shouldered and cheerfully and efficiently carried out.

The private banks will not be disturbed so far as their constitution is concerned. In due course, through the working of the Inheritance Law, their shares will become vested in the National Estates. Meanwhile, their Boards will be placed under the general supervision of the Banking Board. If any differences of view should arise between members of the banking system and any of the other Boards—the Foreign Exchange Board, the National Investment Board, or the Bank of England, the Central Board of Trade Associations, etc.—the matter is first to be submitted to the Banking Board, and should agreement not be reached, the Economic Council will act as arbitrator. Seeing that the scope of the banking system will be confined in the main to dispensing self-liquidating credit to the business

community, carrying out exchange business on behalf of the Gold Settlement Fund, carrying out the provisions of the law concerning the National Investment Trust in so far as they impinge upon the banking system, and to rediscounting at the Bank of England if required, sources of conflict should not be prolific.

Freed from the incubus of unbalanced current international payment accounts by planned interchange of goods and services with foreign countries, safeguarded against the consequences of capital migrations by the working of the Gold Settlement Fund, the financial system under the new order will, by the reforms above outlined, have achieved complete emancipation from the dictatorship of gold and from the despotic powers wielded by the private banking institution which, by its control of the volume of credit, determines the course of the long-term rate of interest: the Bank of England. The drop in the price of Government securities in the past year is a significant warning of the scope of those powers.

At the same time, the complete adaptability of the credit structure to the planned needs of the community at the highest conceivable level is assured. The sterilisation of gold will be accomplished without any disturbance of the circuit flow of money either now or later, when the gold may require to be used to fulfil its function of settling adverse balances in international payments account resulting from capital migration. Gold has lately been sterilised under our present system, but the link between gold and the credit structure remains unsevered, and co-ordinated control either of current international payments or of capital movements is non-existent. Will that gold be restored to creative energy as readily as it has been sterilised? Will the necessity for shipment of gold abroad, if it arises, influence general credit policies. I believe it permissible to doubt whether the Bank of England, under its present régime, will ever be capable of shaking off the fetters of tradition. The traces of past excesses—in deflationary tactics—are still only too clearly discernible below the surface of the Old Lady's otherwise inscrutable visage. Expansion of

self-liquidating credit, indispensable if securities are not to be forced on to the market through growing trade demands for money, is being represented as encouraging dangerous boom conditions ! Surely we have reason to suspect that the Old Lady has a secret hankering after the old life which in public she professes piously to have forsworn!

This danger will for ever be removed under the new order. The volume of money cannot be tampered with any longer. Through the combined effect of the reform of the banking system and of the centralisation with the National Investment Trust of all money withdrawn from use in absorbing goods and services, the actively circulating bank deposits will, at all times, be adequate to aliment the flow of money at any level required to ensure the fullest employment of the productive forces in the community. The problem of idle deposits is dealt with so as to occasion no disturbance and to render them available when needed.

The first five chapters of this section we have in the main devoted to a brief sketch of the technical features of the New Order. There remains another aspect to be considered. The sense of justice and equity of the community will not be satisfied with a smooth working machine, great though the boon of victory over trade depression will be esteemed. The perpetuation, as a matter of course, of wealth and position which, with relatively few exceptions, characterises our society, in the long run undermines its stability. We shall have a few remarks to offer on this subject in the succeeding two chapters.

Chapter 26

THE CONTROL OF INHERITANCE

Christians, that is, they who have unconditionally accepted our Lord Jesus Christ as the incarnation of God, recognise that success in the material world has no significance in the sight of God.

However effectively God-given natural talents, favourable opportunities, educational advantages, may have been seconded by hard work, devotion to duty, integrity and other virtues, we can at best consider ourselves " unprofitable servants ", all whose puny efforts would have been vain but for God's mercy and grace.

Even those who do not believe in God and who, each according to his lights, substitute other " principalities and powers " for His Holy Name, will not accept worldly success as a true badge of worth.

It is natural, therefore, that a sense of injustice should be provoked by the apparent anarchism in the realm of the allocation of this world's goods.

Only faith realises that God does not *will* the evil of this world, and if He leaves our perverse wills free rein and permits the suffering and degradation it entails, He is suffering with us and through us, while all the time His purpose for mankind, the Kingdom of God on this earth, remains unchangeable. In His infinite compassion, and in spite of our transgressions, He still wills only our good, and even suffering can, in His divine wisdom and power, be used for His ends.

That inequality of reward for equal effort or, which is the same in an inverse sense, identical reward for unequal effort, is the exercise of God's prerogative to deal with His children as He pleases, Christians know from Our Lord's revelation (Matthew xx. 1-16), and they are en-

abled, through His grace, to submit to it without covetousness, jealousy or resentment.

It would be a complete misconception of the Spirit of God, however, if, on the part of those who are favoured by this inherent inequality, it spelt acquiescence in the features of our society which tend to perpetuate glaring discrepancies in the sharing of the material bounties of God's earth. For equality of *opportunity* is of the essence of God's Kingdom and, therefore, must be right for this world.

Whatever our surroundings or upbringing, His love makes no distinction of any kind between any of us, and our right to serve Him is subject to no limitation from any worldly cause.

It is fundamentally wrong, therefore, that mankind should have so shaped its material affairs as to doom the vast majority of the descendants of the economically weak and uninfluential to continue in that state, whilst, on the other hand, the vast majority of descendants of those more favoured from the material and social point of view are assured of some place on the higher rungs of the ladder of prosperity.

If all that Christianity is to mean is the expectation of the meek submission of the ill-favoured to a system which offers them and their offspring scant hope of emergence from the drab existence which is theirs, then the exasperation engendered by our Lord's teachings is understandable. But let us not deceive ourselves.

It is by our *mock* acceptance of the way of life our dear Lord revealed to us as the will of the Father that we are placing Him in that false light and exposing Him afresh to the curses and hatreds which were heaped upon Him when he dwelt among us in the flesh by those who fiercely resented the exposure of their hypocrisy. Unless we are willing, for His sake, to accept the obligation of sacrifice in the interest of our fellow-beings, and cease to believe that the only fellow-beings that concern us are those personally near and dear to us, we are not Christians but deserters, salt that has lost its saltness, to which no amount of

"piosity" can restore its savour, and we shall not escape the fate that attends His executioners: destruction.

If any solution to our economic problems is to have permanence, they must be approached in that spirit of readiness to forgo what we have been wont to regard as inalienable rights, if by so doing the community is served. Nothing short of that spirit will avail.

The grave obstacles to true equality of opportunity in our present order are our system of inheritance and the material advantages which the mere accident of birth bestows upon the offspring of the well-to-do and well-connected, through education and patronage. With these privileges I shall deal in the next chapter.

So far as inheritance is concerned, the New Order will satisfy the legitimate aspiration of the individual to see the necessities of those dependent upon his income during his lifetime provided for after his death, in so far as practicable. On the other hand, it will remove the injustice inherent in the passing of control over the means of production by inheritance. Such control involves the perpetuation of privileges and influence in the material affairs of the community without effort. In cases where the income of the estate exceeds current requirements of the beneficiaries, it may even enable the latter and their descendants to secure a constantly increasing proportion of the nation's material wealth without any active contribution being required from them.

Under the New Order the right of bequest will, with certain exceptions, be limited to the income of the estate. No one will be entitled to legate income in excess of £5000 in the aggregate.

The assets comprising the estate, other than those referred to below, cannot be bequeathed, and upon the death of the testator, ownership will be vested in the National Estates, of which mention was made in the previous chapter in connection with the acquisition of the shares of the Bank of England. Those assets will thus revert to the community, subject to the usufruct as outlined in these proposals.

Personal effects will be exempt from this provision, as well as a sum of up to £500 with a view to providing for outlays incidental to rearrangement of affairs frequently entailed by demise.

Regarding houses and land, special conditions will apply. Inasmuch as dealing in house property, though supervised and regulated through the National Investment Trust, remains, under the New Order, free to the living, house property may be left by will. Bequests are limited to one house per beneficiary. Any land adjoining such houses, indispensable for the preservation of their residential amenities, may be left with the house up to a specified maximum area for each house. The remainder, if any, of adjoining residential land, including sporting, park and other pleasure estates, will revert to the National Estates. The latter will, in consultation with such bodies as the National Trust, local authorities, agricultural experts, determine what use is to be made of the property. In any case, it will not remain idle in private possession. It will either be let or sold for farming, or for building purposes, or thrown open as pleasure grounds for the public.

The rental value of the property left to private beneficiaries will be assessed by the National Estates, with appeal to the Courts, and will be considered part of the income legated, for the purpose of computing the total of income bequeathed.

Land not already built upon, apart from private estates, may be left only for farming or building by the beneficiary, up to a maximum area specified by law or up to a maximum rental value, which, having regard to other income legated, shall not cause the total income bequeathed to exceed the maximum permissible by law. The beneficiary will have a limited period within which to determine whether he will accept the bequest of land on these terms. If he declines he will be entitled to receive an annual income for life equivalent to the assessed rental value of the land, provided the total income from the estate is not less than the total income payable to beneficiaries under the will.

Should the total income bequeathed by a testator exceed

the income of the estate or the amount permitted by law, all bequests will be reduced proportionately. There will therefore be no priority as between beneficiaries in regard to the income allocated to them in the will of the testator. Obviously, if such priority were countenanced it might result in no income being available for beneficiaries ranking low in the scale of priority.

Usufruct granted during lifetime, or any arrangements whereby unconditional title was not vested in the beneficiary during the lifetime of the testator, will lapse after his death, and the assets involved will become part of the estate. Gifts absolute during the lifetime of the giver, however, will still be recognised provided they are made not less than three years before the death of the donor. No secret arrangements depriving the beneficiaries of such gifts of the use of the assets or their proceeds during the lifetime of the donor, or imposing any restrictions whatsoever upon the title of the beneficiary, are valid.

Proceeds of Life Insurance policies becoming claims by the death of the insurer, must be paid to the National Estates and the balance, if any, remaining after the maximum cash payment to beneficiaries above referred to, will be invested in shares of the National Investment Trust. The income will form part of the income of the estate. If no indication is contained in the will whether the income, if any, willed to the beneficiary of the insurance policy is to be in addition to or including that derived from the proceeds of the policy, it will be assumed that the former is intended.

Pictures and objects of art will be included amongst personal effects up to an appraised value of £500. The balance will become the property of the National Estates, but may be left in the custody of the beneficiary under a bond, provided he is willing, should the collection be regarded of sufficient public interest, to throw his house open to the public for the purpose of viewing the collection for a specified number of hours at specified times. Failing such agreement, the collection may be transferred to a museum or disposed of in the discretion of the National

Estates, after obtaining advice by a committee of experts. The value will be credited to the estate but proceeds will be used for grants for acquisitions by public musea. During the lifetime of beneficiaries under the estate there may, therefore, be a liability upon the National Estates to pay income to the beneficiaries without corresponding income producing asset. It will be defrayed out of excess income over the maximum bequests in the case of large estates. In any case the uncovered liability will lapse upon death of the beneficiaries concerned.

The National Estates, which represents the community and with whose constitution we are already familiar (see previous chapter), will, through the organisation of the National Investment Trust, administer such assets as are transferred to it, in the interests of the beneficiaries of income derived from the same. Upon the death of any beneficiary, the security of the income of the remaining legatees will be correspondingly enhanced. Not until all beneficiaries are deceased will the assets which comprise the estate become the unconditional property of the nation, through the National Estates. Meanwhile, the lapsing of the obligations to pay out income, through the death of beneficiaries, will ensure to the nation growing revenues from the assets vested in the National Estates. Moreover, from the outset, estates yielding over £5000 per annum will provide a source of income to the nation.

Estate duties will be abolished. Not only will their suppression be more than amply compensated by the saving on unemployment assistance which the new order will permit from its establishment, but the revenue to be derived from the National Estates will increase cumulatively, and, in addition, the profit share of the State in the results of the National Investment Trust will attain substantial and constantly increasing figures.

Ultimately, all assets, except such houses, land and investments as are owned by the living generation, will be vested in the National Estates. Through ownership of the shares of insurance companies, investment trust companies and other institutional investors, it will also control the

securities existing prior to the establishment of the New Order, except such as are held by the National Investment Trust and permanent holders, f.i. churches and charitable institutions. As time goes on, however, estates will, apart from fixed property, consist in the main of shares in the National Investment Trust, and thus the National Estates in the long run will be given control of the Trust also.

In view of the fact that the National Investment Trust and its subsidiaries will, from the outset, build up the organisation requisite to administer its ever-expanding holdings, the National Estates will utilise their services to look after its own holdings, for a remuneration. This will avoid duplication and overlapping, as both the National Investment Trust and the National Estates will frequently own an interest in the same concerns.

As time goes on, the National Estates holding in most concerns will become a controlling one. Suitable arrangements will, of course, be made for representation on Boards, either by existing members acting as nominees of the National Estates, or by the appointment of additional directors, but there can be no fundamental conflict of interest, as the achievement of the best results is in the interest of those directly associated with the enterprise, as much as in that of the owners, the community.

A word may be said about the position of charitable bequests under the New Order. These must remain within the aggregate income limit of £5000 per annum. Gifts during the lifetime of the testator will be valid, but as it is obviously not to the interests of the community that the control of capital assets should, in any undue measure, pass to charitable institutions, it is necessary to protect the community against alienation of such assets in that form. Inasmuch as charitable institutions would enjoy, in perpetuity, the income from assets donated to them, any prospect of the community as a whole deriving any benefit from them would be excluded if unlimited gifts were permitted. Though the nation would, of course, readily make sacrifices to alleviate distress, it must not be overlooked that the entire aim of the New Order is to ensure

the highest degree of well-being to every one of its members consistent with aggregate productive power employed to the full. That such standard of well-being will be vastly superior to that now prevalent is not in doubt, and the financial resources of the State will be ample, as mentioned above, to leave a substantial and rising margin over necessary outgoings. A proportion of the surplus will be used to replace services now supplied by charity out of voluntary contributions and which, reorganised and modernised, will be at the disposal of the public as of right. Charitable funds will thus be largely released to increase amenities, entertainment, instruction, country holidays, etc. Hence, apart from the limit upon annual income which may be left by will, there will be a limit upon valid gifts to charity within three years prior to death. If such gifts represent more than one-fourth of the value of the estate plus the gifts, any excess is to be restored to the estate. In so far as the income of the restored assets, together with any income legated by the testator, does not bring the total income covered by bequests over the maximum of £5000, it will be paid annually to the charitable organisations concerned. Estates, the income of which, together with the income of the charitable gifts within three years prior to the death of the testator, does not exceed £5000 per annum, are exempt from this provision.

Without violent change or despoilment, the effect of the range of measures above outlined will be to remove once and for all one of the principal barriers to true equality of opportunity.

Such privileges as will still be attached to the enjoyment of income without work, through accident of birth, can, under the New Order, no longer entail financial operations prejudicial to the interests of the community. Not only are all ways of dealing with money disruptive of the money flow amongst goods barred, but the employment of surplus income along lines calculated to maintain economic activity at the highest attainable level is assured, as described in previous chapters.

Moreover, the control of the assets themselves from

which the income is derived is in the hands of the community through a body controlled by Parliament—the National Estates.

The constantly expanding wealth of the nation, reaching to all the corners of the earth through wise and productive lending abroad, will permit a rising standard of living of the community, and will assure more leisure and greater amenities to all its members. To those who have the well-being of their fellows at heart, this prospect will afford ample compensation for the vicarious sacrifice involved in the limitation of the power of bequest of the individual.

Chapter 27

AN EQUAL START IN LIFE

A NEW ORDER could be made to function perfectly smoothly from the technical point of view without true equality of opportunity. We should be deluding ourselves, however, if we imagined that lasting harmony within the community could be achieved so long as the glaring differentiation that faces the children of the poor from birth and dogs them through life is permitted to continue.

Beginning with unhygienic surroundings and under-nourishment and such congenital handicaps as penury of the parents may have induced, it persists, with relatively few exceptions, in the frustration of prospects of a career through inability to afford, or take advantage of, opportunities for more advanced education.

Even in the attitude of mind towards the lowly, there is, often unconsciously, the reflection of a tendency to regard their drab and forlorn existence as pre-ordained, inherent in the order of the world, with which it is inexpedient to tamper.

Such fatalism and complacency is in nothing akin to the divine spirit. We could not conceive the God we worship indifferent to, or in any sense quiescent in, the sufferings of His children. Rather are we persuaded that His Sacred Heart is moved to compassion at our ills, grieves at our sins and rejoices in our victories over them. Can we, who believe in this identification on His part in all that concerns our own existence, material and spiritual, and claim it as our solace in all that befalls us, yet remain apathetic and aloof where the fate of whole masses of our fellow-beings is involved?

It is true that this aspect is outside the domain of economics and finance, but I cannot ignore it, for the "New Money" outlined is for "New Men", that is, for Christian

revolutionaries. Their type of revolution does not involve despoilment of others by force, but revolution within themselves that leads them to strive for a higher plane of life, where they may emerge into the main stream of light held up to us by Jesus, instead of being content to remain in the "backwater", as Bishop Carey of Bloemfontein so tellingly styles the spiritual habitat of those who shun the effort which ascension towards that light involves. In that spiritual revolution there are no polling dates. It is a secret and eternal referendum in which the individual casts his vote for God or against Him. The results are known to God alone. His rule is not established by absolute majority, for the votes in His favour have, by divine grace, been endued with the quality of leaven. Their power to "raise" other votes is infinite. So shall the day of judgment arrive when God will know His own and His Kingdom shall prevail.

The object of the measures to be put forward in this chapter will in no sense be to level what cannot be levelled: individual talents, intellectual gifts, character, aptitudes; nor to equalise that which should not be equal: material rewards. It must be to ensure that the community shall offer an *equal start in life* to every one of its sons and daughters, in so far as that depends upon the will of Man. We abhor class warfare. We look upon those who preach it as enemies of society. But it is we who have by our own apathy and acquiescence permitted the division of the community into classes. In the main there are two:

Firstly, those born in surroundings giving reasonable assurance that, with few exceptions, all careers to which material advantage, distinction, influence and social standing attach, will be filled by them,

and

Secondly, those whose origin, broadly speaking, leaves them without hope of rising above manual labour.

These the new order will aim at welding into one. Two sets of obstacles at present militate against this consummation:

Firstly, *poverty of the family*, involving the urgent

necessity for the child to contribute to family income at the earliest possible opportunity. In the vast majority of such cases, extended education is ruled out altogether.

Secondly, *the cost to the community* that would be entailed by the provision of free extended education in the case of young persons desiring it, qualifying for it, and whose further intellectual or technical development is judged to be in the interests of the community, though their parents may be unable to afford it.

The subject is too vast, and my knowledge of the problems of education too limited, to do more than sketch in the broadest outline proposals for dealing with it. When the establishment of the new economic and financial order, laid down in this book, is taken in hand in earnest, expert brains and experience will build upon, or reconstruct, the framework of equality here laid down.

The first set of obstacles resolves itself into a question of distribution of the product of the community's labours. Under a planned society, governed by the new economic and financial order sketched in this book, with fear of unemployment and trade depression removed, with fundamental changes in the distribution of income through limitations upon bequests and with vast accretions of income at the disposal of the State for re-allocation in ways best calculated to benefit the community, the bargaining powers of labour will essentially be greatly strengthened. The spectre of poverty eliminated, the ever-threatening surplus of available labour absorbed, negotiations for better terms will be practicable without that aggressiveness which invariably characterises the demeanour of those actuated by fear, the worst feature of our present society, which drags down its standards, strangles its progress and gives rise to appalling distortions in human relationships.

I desire to see this vastly stronger position of the workers underpinned by minimum wage provisions throughout the land for all grades of workers in every trade and industry,

the average weekly earnings in which were below a given level, estimated to be indispensable for a decent existence free from pressing material cares. Prevailing house rents would no doubt afford a suitable basis for the division of the country into districts and the establishment of an equitable scale for each, subject, of course, to revision from time to time.

It will end the scandalous exploitation of human beings, notably in the retail trades, in agriculture, in shipping, in the employment of travelling salesmen, etc. These latter will require a special régime. Under its provisions it shall be unlawful for any employer to offer to any travelling salesman terms of employment that do not provide for payment of a fixed wage at least equal to the minimum legal wage that will be applicable to travellers, plus actual outlays incurred in the employer's interests. In the case of part-time travellers, payment should be *pro rata* to the number of hours per week the employer expects the traveller to devote to his affairs, which must be agreed upon in each case. Should any traveller not be able to contract for a sufficient number of hours to attain an income equal to the amount which he would have received in respect of unemployment insurance, he will be entitled to claim the difference as relief. If results indicate that he is unsuitable for travelling other work will be available. Travelling salesmen will be free to establish themselves as master salesmen, in which case they will not be regarded as employees and can make any arrangements mutually agreed upon, but there must be evidence in every case that they have been given the option by the parties on whose behalf they sell goods, to accept arrangements under the minimum wage conditions outlined above. No longer will it be possible to abuse the pecuniary plight of men ineligible for unemployment benefit, by using them to peddle goods from door to door without wage or travelling allowance.

At the other end of the scale a maximum salary will be fixed, in order that the object of the redistributive measures should not be defeated by inordinate accumulations during lifetime which those in positions of power might agree to

allocate to themselves in the form of salary or other emoluments. The case of the American bank chairman who, prior to his enforced resignation as the outcome of disclosures concerning his speculations in the shares of his bank, had a pension for life of $100,000 per annum voted to him, is a warning example of the lengths to which abuse of power may go.

Profit-sharing will be encouraged but must be extended in certain contingencies to every wage and salary earner in the enterprise. When, in any enterprise, there are officials whose total earned income exceeds the maximum as a result of commissions or profit share, such incomes shall be aggregated and their average excess over the legal maximum salary ascertained. The ratio which that average excess bears to the maximum shall be the ratio in which all servants of the enterprise shall be entitled to additional remuneration in excess of their wages and salaries. In the case of partnerships, or business owned by an individual, a slightly different method will be adopted, inasmuch as the owners would normally be entitled to all profits. If the aggregate profit available for the working partners exceeds the amount of the maximum salary multiplied by the number of working partners, that excess would be shared between partners and employees. The basis of this division would be the ratio between partners' remuneration at maximum salary and the amount of the staff pay-roll. Thus, in a business with two working partners, having a staff pay-roll of £15,000 and showing an amount of profit available for the working partners of, say, £11,000, there would, on the assumption that £5000 was the maximum salary fixed by law, be £1000 to be divided between partners and staff in the ratio of 10 to 15 = 2 to 3. The partners would thus receive in all £10,400, the staff, £15,600.

Along these lines, a powerful redistributive factor would be constantly operative. In the event of losses, redistribution in the other direction is normally effected by reduction of salaries and wages and by discharges.

By a combination of supplementary measures, merely hinted at above, the fundamental reforms introduced by

the new economic and financial order would thus be confirmed and consolidated, and the principal obstacles to an equal start in life, in so far as they spring from penury of the family, will prove capable of being fully overcome.

The next step must be to devise the means whereby the fullest benefit may accrue to the nation, and to the individuals concerned, from the opportunities that will be made available to each successive growing generation.

In a planned society it is possible to estimate the need for human energy and productive power over the entire range of the activities of the community. Vital statistics afford a reliable basis for calculating the number of boys and girls of 15 who may be expected to reach the various ages at which their services would be needed in the several occupations they will ultimately follow.

To the community as a whole it is obviously of the utmost importance that, in every sphere, the work should be done by those best qualified and, so far as possible, having a preference for the task they will be called upon to perform.

Towards that end, education will be divided into three main groups:

1. The "normal" up to the age of 15.
2. Vocational training from 15 to 18.
3. Advanced education from 15 to 21 or longer.

Normal education will be equalised throughout the length and breadth of the country. There will be no distinction in curriculum between private schools and schools run by public authorities. It will be established so as to incorporate the best features anywhere to be found.

After the age of 15 one of two divergent educational courses will be available: vocational training and advanced education.

Vocational training will be subdivided into:

(*a*) Preparatory course;
(*b*) Complementary course;
(*c*) Extension course;

each of one year's duration.

Advanced education consists in :

(*a*) Intermediate education, of three years' duration, preparatory to entry into a university or institution of learning assimilated to universities.

(*b*) Higher education, comprising study at a university or assimilated institution.

The year's preparatory course of vocational training will be free and open to all who pass a final test upon leaving school. No one will be permitted to accept employment for gain under the age of 16. Hence, only those children whose personal help in the household is indispensable will, it is expected, be deprived of the opportunity to enjoy for a further year at least the educational advantages to be placed at their disposal, free of any charge.

At the age of about 14, say, a year before " normal " school-leaving age, all children will be invited to indicate, in order of preference, three choices of a career. Comments from parents upon the choice will then be solicited. A psychological test will be made in the case of each child by experts with a view to determining, in so far as science permits, how the child's aptitudes fit in with the preferences evinced or with the parents' views where these diverge from the selection made by the child.

Before the close of the final " normal " school year, the children will once more be asked to state their choice of a career, but this time only one is to be recorded. This will be compared with the data already on record and if it concords with the earlier choice, the parents' comments and the psychological report, it will be assumed to be the right choice. Likewise, if the latest choice differs from the earlier one but corresponds to the impressions of parents and psychologist, it will go unquestioned. If, however, the child has not wavered in adhering to its original preference and there is divergence between this and the views of parents and psychologist, or where the child itself has put forward a new choice which still differs from the opinions of parents and psychologist, whether the latter be agreed or divided, the alternatives suggested by parents and psycho-

logist will be discussed with the child on behalf of the educational authorities. Should it still insist upon the preference for its own choice and should that differ from any of the preferences listed in the earlier selection, a new psychological test will be made and the child informed if it reveals definite disabilities for the career selected, though if it remains of the same mind its wishes will be respected.

These preliminary investigations will permit of all children upon leaving school being directed into one of the two main streams: vocational or advanced education, according to the careers chosen for which a preference was expressed, and—in the case of divergences with the judgment of parents and expert—of ensuring that the child shall have had every opportunity of considering alternatives and realising the drawbacks, if any, to its own choice, inherent in its make-up, physical or intellectual.

All those whose choice of career does not involve advanced education will be admitted to the preparatory course of vocational training upon passing a school-leaving test, which will be non-competitive. Anyone failing to pass will have another opportunity three months or a year later, in the option of the pupil, but a second failure will disqualify from further free education.

An entrance examination to the "intermediate stage" of advanced education will have to be passed by all whose choice of a career requires ultimate admission to a university or assimilated institution, and none except successful aspirants will be accepted at colleges, high schools and other educational establishments that are devoted to training of the "intermediate" type. As it is anticipated that the number of those desiring careers involving advanced education will exceed the posts of that kind likely to be available upon termination of the studies, the entrance examination will be competitive. A number sufficiently in excess of that calculated ultimately to be required, to allow for failures and contingencies during the study period of at least six years in the aggregate, will be admitted to the intermediate stage. Those who fail to pass may sit

again in three months or a year, at their option, but a second failure debars from advanced education at the intermediate stage. If the normal school-leaving test is successfully taken, however, the pupils rejected for advanced education may enter the preparatory course of vocational training. They need not give up all hope, even then, of ultimately gaining their objective, as, subject to their having successfully qualified for the complementary and extension courses of vocational training, they may, after completion of the latter, sit for a competitive entrance examination to a university or assimilated institution. These latter will be fed by two currents: the main stream from the intermediate stage of advanced education and an auxiliary one from the vocational branch. Thus the aspirants for the legal, medical, engineering professions, etc., who saw their hopes disappointed at the entrance to the intermediate stage, and might have had to content themselves with posts as lawyers' clerks, chemists' assistants or mechanics, artisans, etc., after three years of vocational training, may yet see their ambitions gratified if, by dint of private study, apart from their vocational training, they succeed in passing the competitive entrance examination to the higher stage of "advanced" education.

Whilst the first, or preparatory, year of vocational training is free to all who pass the normal school-leaving test, admission to the next two years' courses is subject to competitive examination and to payment of a graduated fee for those whose parents have an income in excess of a certain figure. Below that limit the State will bear the cost. Above it, the fee is assessed on the basis of liability to income tax, and when the income exceeds a level fixed by law, full fee is payable. There is no obligation upon parents to permit their children to follow the complementary or extension courses of vocational education, for which they may qualify, but in view of the enhanced prospects of a remunerative career which such further training will open up, and the liberal exemption limit and slow progression that will be adopted in the fee scale, it is anticipated that few that pass the test will miss this chance.

By and large, the unskilled manual labour of the country will be supplied from the ranks of those with only one year's vocational training who, either from choice or from inability to meet the tests provided, do not pass to the complementary course. Between the ages of 16 and 17 there will be no wage limits and during that year young persons will be free to accept, at any wage, any employment not expressly forbidden by law. Between the ages of 17 and 21, however, minimum wage scales for each year and every kind of job will be established, graduating up to the full minimum scale for adult workers from the age of 21 upward.

All those whose choice of a career involves vocational training of any description beyond the first or preparatory stage, must qualify by competitive test for admission to the " complementary " course in the group selected. The numbers of successful candidates must not be permitted to be greatly in excess of the likely demand in each group for young men and women possessing such training. A second chance will always be open to rejected entrants as previously outlined. To the tests will also be admitted those from the corresponding year in the intermediate stage of advanced education who, for one reason or another, are not pursuing that course. It is probable that these latter would find no difficulty in passing the test from the point of view of general knowledge but will need coaching in a technical sense.

The third, or " extension ", course of vocational training will be open to the successful participants in a competitive test between those whose projected career demands still higher technical skill and knowledge in industry, chemistry, mechanics of every description, wireless, accountancy, etc. As the number of jobs available tapers off towards the higher ranges, competition at the tests for the extension course is likely to become more severe. Of course, the system here outlined does not, in the least, doom those who fail to pass the tests to permanent disqualification for posts necessitating the more intensive training. There is nothing to prevent them from gaining the necessary theoretical knowledge through private study and the practical ex-

perience by zeal and application in workshop, laboratory, factory, chambers, etc.

As regards the advanced educational branch, if estimates of the number likely to drop out at the various stages by the vicissitudes of life, lack of ability or inadequate study, prove approximately reliable, the number of men and women ultimately graduating from the universities or other assimilated and specialised institutions of learning should correspond to the demand for their services in the different branches. They should find no difficulty in earning a living—the more so as they will be engaged in the very branches of activity for which they have a preference and in which, step by step, they had to qualify in competition with others headed in the same direction. A year before completion of the intermediate stage of advanced education, *i.e.* at the age of about 17, a further census of preferences will be taken and anyone who so elects may undergo a free psychological test conducted by experts, with a view to ascertaining whether his choice coincides with the expert's conclusion from the test. He will receive a copy of the expert's report and it will be left entirely to the student's discretion whether he wishes to follow any suggestions the psychologist may make.

Fees for " advanced " education will be assessed on the same lines as above set out for vocational training. Whilst there will be vocational training establishments in all sizeable towns, there will, of course, be far fewer intermediate schools and still less universities and assimilated institutions. Hence, in a large number of cases, those enjoying advanced education will not be able to live at home and grants will be made by the State for the whole or part of the maintenance of such students on the same principles which govern the assessment of fees.

Scholarships will not be affected. If the winner comes under the " free " class or in a bracket entitled to receive State contribution to food and maintenance expenses, he will be able to claim such assistance just the same and the scholarship will be available for defraying the balance of the cost or for investment on behalf of the beneficiary.

The educational apparatus would have to be reformed and considerably enlarged in the vocational branch. So far as intermediate and higher education of the " advanced " branch is concerned, it will no doubt be found that existing establishments will be able to meet all requirements of a planned society.

The expenditure involved, both in the provision of facilities for a year of free vocational training and in the contributions towards fees and maintenance allowances which the State will be called upon to make under the new régime, should be amply covered by the saving on unemployment assistance, the Government's share in the profit of the National Investment Trust and the State's growing income from the National Estates, even after allowing for abolition of death duties and for remissions of other forms of taxation under the new economic and financial order.

Within the educational framework sketched above there are bound to be individual cases requiring special consideration. For that purpose committees will be set up to deal with any controversial questions in connection with the educational problems of young persons after they leave " normal " school.

Unlike the others, this chapter has not been concerned directly with technical defects in the working of our financial and economic order. The proposals it contains form part of that new outlook on which I have laid emphasis at the outset of this section, and without which no New Order can be lasting. It is no less indispensable in tackling the problems surrounding the preparation of growing generations for the place they are to fill in the economic life of the community, than it is in the spheres that more directly impinge upon the current conduct of material affairs.

In assuring to all an equal start in life, the community as a whole will benefit. Its work will be performed in every sphere by those trained and—in the vast majority of cases—having a preference for the tasks on which they are engaged, and for which they will have shown themselves fitted in competition with others, in so far as that is practicable in the educational stage.

Together with the other features of the New Order, the vastly higher standard of efficiency which will become practicable in every direction as a result of the educational reforms here set out, will operate to increase the amenities of life and ensure enhanced leisure. In a society from which unemployment and trade cycles are banished, the entire attitude towards work will undergo a fundamental change. Idle spenders may appear as semi-benefactors in a State where unemployment is the rule; not so under a New Order in which the standard of living and leisure for all depends upon the maximum effort of all, within agreed limits of working time. Men between the ages of 21 and 50 who, of their own choice, are not, during at least eight months in the year, engaged in pursuits falling within a classified range of recognised economic activities, will be subjected to a special tax to compensate the community for the damage inflicted upon it by their unproductiveness. The tax is payable by themselves or by those who subsidise their idleness.

Unmarried women between 25 and 50 are similarly taxable if they do not follow an occupation for which they are eligible.

The range of recognised activities for women will include *regular* charitable and welfare work, as well as domestic assistance at home. The latter type of occupation will be subject to conditions which will leave it fairly established that it is not used as a cloak for idleness.

Inequality in the New Order will still exist, but it will be of a kind inherent in God's order for the world, dependent upon the varying degree of intelligence, the ability and character with which He has endued His children, and the zeal and endeavour each puts into the task of turning those gifts to account.

Happiness, of course, belongs to another realm. One of the purest and most refreshing sources of human happiness lies in the knowledge that our fellow-beings care for us. It comes next only to the happiness experienced by those who are themselves dispensers of unselfish love. The two types are not mutually exclusive but reciprocally generative.

Such love is of God, for, transcending personal affinity, it encompasses all mankind.

If, therefore, the type of material order which we create is permeated with tangible evidence of that spirit of self-sacrifice—which is but another term for true love—the foundations on which lasting happiness may be built will have been provided.

Chapter 28

OUTLINE OF ORGANISATION FOR A NATION OF TRUSTEES

In the preceding chapters of this section the reforms which the New Order necessitates have been set out piecemeal. I shall now sketch, in broad outline, the organisation that will emerge.

The mechanism of the capitalist structure will be retained. I know of no other offering complete adaptability to the ever-fluctuating requirements of economic interchanges and, at the same time, the fullest scope for the development of enterprise. It is not necessarily wrong merely because it suits the wealthy. That, under the present order, it permits and encourages grave inequities, that it provokes and accentuates glaring inequalities, that it breeds and propagates grave conflicts, study of its operation in the foregoing pages will have amply demonstrated.

Its defects, however, are inherent, not in the system, but in its present technical constitution and in the latitude it affords to the individual to pursue conduct inimical to the welfare of the commonwealth, however well intentioned his actions may be, and however innocuous they may appear.

Purged of its baneful features, the capitalist structure under the New Order will be subordinated in every one of its aspects to the interests of the community as a whole. In fact it will transform us into a Nation of Trustees.

Since no man can leave the assets of which he dies possessed, except to the nation and, subject to restrictions, to charity, he administers them during his lifetime as a Trustee, in the first place for the community, and, in addition, for those to whom he may bequeath the income within the limits permissible by law, and for the charitable institutions, if any, who may benefit under his will. Anyone may still squander his substance during his lifetime if he so

wishes, but there will be no way under the New Order whereby assets or income can be so dealt with as to prejudice the interests of the public at large. He cannot speculate with money borrowed against his assets, for the banking system is forbidden to lend for speculative purposes. Whilst big holders of existing securities might still attempt to manipulate markets, the scope for operations of this character will be much reduced under the New Order, since dealings in existing securities will become largely a matter for negotiation, and the flow of money circulating amongst such securities will be carefully regulated by the National Investment Trust. Nor can current surplus income available for investment be utilised in any manner harmful to the community, for, unless it is employed direct by its owners in enterprise, it must find its way to the National Investment Trust, to be restored by the latter to the flow of money amongst goods and services, as described in Chapter 24.

Finally, the capitalist is prevented from sending his money abroad, there to be free to do what is gainsaid him at home. Thus, all the potentialities for evil, conscious or unconscious, that, under our present system, adhere to the dealings of capitalists, or of those in enjoyment of excess income, are not only frustrated, but converted into forces actively beneficial to the community. Willy-nilly the capitalist is moulded into a Trustee. This applies equally to the small savers, the little capitalists, whose aggregate surplus for investment is an important factor. Their deposits in savings banks, or income left idle in banking account, will in due course revert to the control of the National Investment Trust, to be restored to the circuit of commodity money from which these funds had previously been withdrawn.

The banking system will fulfil its Trustee functions by safeguarding the bank money they create against the wiles of the speculator and manipulator, and by ensuring the prompt and unfailing supply of self-liquidating credit for all genuine trade requirements. Likewise, they will act as Trustees in the conduct of all foreign exchange trans-

actions, on behalf of the Foreign Exchange Board, which latter is itself a body of Trustees entrusted by the community with the defence against the devastations wrought by uncontrolled capital movements. Furthermore, the banking system will represent the National Investment Trust in its supervision of the flow of money, so that idle deposits, as defined by the formula laid down in Chapter 24, may be promptly transferred to the National Investment Trust.

The vast and constantly revolving funds representing current surplus income, etc., available for investment, will be administered by the Trustees that compose the National Investment Board. Not merely the members of that Board, however, but the members of all boards of enterprise in which the National Investment Trust is, or becomes, interested as shareholder or creditor, will be Trustees in a much wider sense than hitherto. They were, of course, always Trustees for their shareholders, but under the New Order these latter will indirectly include everyone who holds shares in the National Investment Trust—a large and ever-growing proportion of the public.

As time goes on, there will be vested in the community as a whole, through the National Estates, ownership of assets left through inheritance, and thus, not only the members of the Board of the National Estates, but all those concerned with the conduct of the enterprises represented by those assets, will be Trustees for the nation. In fact, everyone who works in an enterprise in which the National Estates has a stake—and these must gradually embrace the bulk of all enterprise in the country—and everyone who has any holding of shares of the National Investment Trust and works in any concern in which it has a financial interest, becomes a Trustee—in the first case for the entire community, in the second for that section, likely to expand continuously under the New Order, who are shareholders in the National Investment Trust.

Safeguarded against the disruption of the credit system involved in unbalanced international payment accounts,

with the banking system reformed so as to deliver the nation from the tyranny of gold and of autocratic dominion over the central source of credit, a Nation of Trustees can set about the task of planning its interchanges of goods and services, national and international, at the highest level consistent with available productive power.

I have stressed as fundamental, at the outset of this section, the completely new outlook that must govern such planning. Two bodies of Trustees will be directly concerned in the work of planning : the Economic Council and the Central Board of Enterprise. The Economic Council is the supreme planning, investigating and co-ordinating authority for the whole of the economic activities of the country. The Central Board of Enterprise will direct the execution of the plans. The latter is the central organisation of the associations of the groups in which trade and industry of every description will be divided. In a great many directions such associations are already in existence and all that requires to be done is to bring their constitution and scope into line with the needs of a planned economy. Membership of the association for its group will be obligatory for every unit in the economic sphere.

The Economic Council will be nominated by Government—partly by direct appointment by the Chancellor of the Exchequer and the President of the Board of Trade, with Cabinet approval, partly from panels submitted by representative bodies, as the result of a ballot for which regulations will be laid down. The organisations to be invited to submit panels will, of course, cover a much wider range than those represented by the Central Board of Enterprise, inasmuch as the Economic Council will include nominees of manual labour and outstanding authorities in applied sciences, education, psychology, the Services, etc. It is inevitable that its membership should be fairly large, probably thirty to forty, but this should not impair its efficiency, as its labours will, in the main, be carried out by smaller committees. Membership of the Council is a full-time job and all other appointments or connections must be relinquished. The duration of the

first Council will be eight years for one-fourth of its members and six, four and two respectively for the remaining three-fourths, but the mandate is renewable on expiry for further periods of eight years at a time, subject to ballot by bodies from whose panels the members were originally selected and to agreement by the Government. In case of disagreement the Cabinet will decide and is responsible to Parliament for its decision. Membership of the Economic Council carries a substantial salary, not, of course, exceeding the maximum fixed by law. It is probable that, in many cases, acceptance of membership of the Council will involve a pecuniary sacrifice, but considerations of that kind have never, in the past, deterred the best men and are even less likely to do so under the New Order.

The Central Board of Enterprise will be elected by ballot from nominees of the trade associations, and for this purpose the latter will be divided into the same number of groups as there are to be members of the Board. As in the case of the Economic Council, acceptance of membership involves full-time salaried position and severance of existing connections.

The planning requiring to be done falls into two stages. The first or rehabilitation stage aims at adjustment of existing conditions to the New Order and will terminate when the reforms proposed are introduced, and the training and employment of every man and woman able and willing to work is accomplished.

The second or permanent stage is then reached, when the task of the planning authorities is the maintenance of full employment and of the highest level of domestic interchanges of goods and services and of international trade which the available productive forces permit; the ceaseless adaptation of the nation's economic activities to changes in conditions, to the vagaries of public taste, to new inventions; and finally, research into and exploration of all methods for increasing the productivity of the community, and for the fruitful enjoyment of leisure.

Of the first and most arduous programme Chapter 22 has already given a brief sketch. It may well be that the

Economic Council will find it an advantage, as a preliminary to efficient and expeditious planning, to promote a general Enabling Bill to give force of law to voluntary agreements in trade and industry of every description, recognised as desirable both by the Central Board of Enterprise and by the Economic Council. In the alternative, the submission to Parliament of every such specific agreement would entail much unnecessary loss of time and energy and open the door to sabotage by recalcitrant and insignificant minorities.

Means will, of course, be devised whereby one unit controlling the overwhelming bulk of the turnover in any trade or industry shall be prevented from dictating policy for its entire group on the strength of this preponderance alone. It may, for instance, be provided that a majority of *individual* units representing in the aggregate not less than 80 per cent of the turnover will be required, each unit and its subsidiaries or affiliates counting as one. Thus at least 50 per cent of the remaining small units would have to be in agreement with the one big unit, producing alone, say, 80 per cent or more, to permit the plan to be looked upon as an agreed one. Alternatively, it might be laid down that no unit, including subsidiaries and affiliates, shall count for more than, say, 20 per cent of total turnover of the industry. Thus if any unit controlled 80 per cent it would find itself on an equality with the remaining 20 per cent and it would be necessary for small units, representing 60 per cent of the total turnover of these latter, to be in agreement with the big unit before the necessary 80 per cent would be considered to have been obtained. Again, it might be found preferable, in an industry where there is one dominant influence, to form two sub-groups—one consisting solely of the large unit and the other representing the rest. If the sub-group of small units arrived at agreement amongst themselves it might be more readily possible to hammer out a compromise between the two sub-groups. If the small sub-group failed to work out a plan, or if the two sub-groups failed to agree on a compromise plan, the method or methods enacted in the law for general application would be resorted to.

Any measures in the field of trade, industry and finance sponsored by the Economic Council, other than those covered by the Enabling Bill, would be laid before Parliament by Government after they had received Cabinet sanction, or by private members in the unlikely event of the Government dissenting. Parliament would be aware in the latter case that any such Bill had been considered in all its bearings by experts on the subject, in consultation with all the interests involved, and that it represented an agreed scheme to give effect to the conclusions reached. There would, of course, be nothing to prevent Bills in the economic and financial sphere coming before Parliament without having originated with or run the gauntlet of investigation by the Economic Council. It is probable, however, that Parliament would insist upon obtaining the views of the latter, and the opinion of so representative a body could not fail to carry great weight in determining the attitude of Parliament towards the measure.

In the first, or transitory, stage of the Economic Council's activities the training of the unemployed for the tasks that will be awaiting them under the rehabilitation plan will be one of its important concerns. No one will be compelled to accept training or work, but the idle from choice will only receive unemployment benefit, and, like the idle rich, will thus in effect be paying a substantial tax for deliberate refusal to co-operate in the nation's rehabilitation, as the minimum wage under the New Order in every branch of activity will be substantially in excess of unemployment pay ; not as now, in places, barely a few shillings.

The Government rearmament plans will help in the rehabilitation stage, though it will throw a heavier burden upon the Council's shoulders when that tapers off. Moreover, Government borrowing, by absorbing a goodly proportion of the funds that will flow into the National Investment Trust, will correspondingly reduce the money available for increase in the means of production.

The New Order, unlike the present system, is organised so that no expansion of the means of production could be undertaken that exceeded the capacity of the community,

since all resources, on balance currently available for that purpose, would be centralised and shepherded into the appropriate channels.

Even allowing for the absorption of labour as the direct outcome of Government spending, there will remain a large body of unemployment to be dealt with.

It will be for the Economic Council, in consultation with the Central Board of Enterprise, to devise the plans, already referred to in Chapter 22, that will provide for the return to productive activity of all available workers. The nature of the additional goods which they will be called upon to create must be determined with a view to prospects of their finding a market at home and abroad, having regard to the increase in the volume of purchasing power that will be distributed as a result of enhanced economic activity. Under the New Order, the possibility of any of this purchasing power being diverted to uses other than the absorption of goods and services is excluded. Hence planning becomes practicable.

The plans must further take account of the larger imports from abroad that will be needed, firstly of raw materials for the manufacture of the additional goods to be made, secondly of foodstuffs, etc., resulting from higher pay-rolls, and thirdly of certain classes of foreign manufactured goods, the demand for which will be stimulated by diffusion of prosperity. Proposals will be prepared by the Economic Council for the use of the Government, in order that the latter may negotiate with the Dominions and other countries from which these supplementary imports are to be drawn, for a *quid pro quo* in the form of greater purchases from us. Thus the Economic Council will have a basis in advance for estimating the quantity and nature of the goods for export which should be included in the rehabilitation plan of additional production.

It is possible, particularly in a period of rising commodity prices, when producing countries have no difficulty in disposing of their output, that the prospect of additional sales of raw materials and foodstuffs may not have the appeal which it would certainly have in different circum-

stances. It is, therefore, conceivable that we might not fully succeed in compensating, by increased exports conceded to us as the result of negotiation, the larger imports associated with the rehabilitation stage. In that case we may have to face some decrease in our foreign exchange or gold holding. This could not, however, under the New Order, affect our credit structure, and would in any case be a purely passing phase. In due course steps to secure and maintain permanent equilibrium in the current balance of international payments would be taken, as indicated in a previous chapter.

The Economic Council will ascertain, through the Central Board of Enterprise, to what extent voluntary expansion of production would be agreed to by manufacturers of goods and distributors of services to meet the requirements of the rehabilitation plan. If called upon, a guarantee against loss may be given on behalf of the Government on such increased production, but where this is demanded the producers will work, in respect of that additional production, on a commission basis only and profits will go to the State. Books in that case are to be thrown open to Government accountants.

The plans elaborated in consultation with the Central Board of Enterprise will be taken cognisance of by the other Boards concerned in the conduct of the economic and financial affairs of the nation. The National Investment Board will thus be enabled to gauge the long-term financing required; the Foreign Exchange Board will follow the course of exchange operations with full knowledge of the basic facts; the Banking Board will be aware of the volume of additional self-liquidating credit the system is likely to be called upon to supply, and the Board of the National Estates will be interested through their holdings in enterprise of every description.

The operation of the plan so far as production and distribution, import and export, is concerned devolves upon the Central Board of Enterprise, which will transfer to the Association of each group responsibility for carrying out its part in the scheme. The latter in turn allocates to each unit of its membership its proper share.

Thus we reach full production, and, with unemployment eliminated, enter the permanent order under which the planning authorities can devote themselves single-mindedly to the pursuit of ever-growing material welfare for the community. Of the problems with which they will be confronted, the vast majority are amenable to domestic adjustment through the machinery we have described. It is, however, in those spheres where the writ of the Economic Council does not run, where the national economy depends, in part, on factors over which we can exercise no control, or at best a partial one, that the more obstinate difficulties will be encountered. Amongst these, our current external economic relationships, wide, long-term fluctuation in the price level of imported commodities, and new inventions, at once suggest themselves. I have a few comments to offer on these problems in the next chapter.

Apart from these major concerns, other aspects will claim attention. There will, of course, then as now, still be numerous ways in which power and connections can be abused and trust violated. It would be an illusion to think that any plan dealing with the material order, any laws however wise, could eradicate the evil in man. That Power belongs to the Holy Spirit and is shared by all who, submitting their lives and wills to God, claim the fulfilment of that eternal promise, sealed by the prayer of Jesus, whereby the indwelling presence of the Spirit of Truth is vouchsafed to them (John xiv. 15 ff.).

It is through the impact of such souls upon others that God, in His mercy, brings His light to those possessed by the powers of darkness, liberating them and transforming their being.

Meanwhile the impotence of the lawgiver, as such, to do more than exercise a deterrent effect, should not prevent us from striving to deprive evil of its opportunity. In the succeeding chapter I indicate a few measures designed to close up by legislation some of the gaps that leave the door wide open to malpractice, and to strengthen the hands of all those who regard their worldly tasks as the discharge of a sacred Trust.

Chapter 29

OLD PROBLEMS AND NEW SOLUTIONS

After the initial stages of the reforms entailed by the New Order have been passed, we shall be faced with the imperative task of maintaining our trade accounts with the outer world in balance year by year. The economy which we have outlined provides the basis on which progressively an ever-expanding structure of international exchange of goods and services may be reared.

To this end, it is first essential that the convenient myth of automatic three-cornered trade be abandoned. The theory that if we buy more from one country and the latter is thus enabled to buy more from a third, then the third will buy correspondingly more from us, has been amply demonstrated a fallacy in the experience of the past twenty years, and this is being constantly confirmed. If we want balanced trade, whether direct, three-cornered or polyangular, to be a reality, we must create it by negotiation.

We shall be in an unrivalled position to undertake such negotiations in anticipation of the whole of our productive forces being fully engaged on effectively planned and well directed lines. This will give us the certainty of being able largely to increase our purchases of raw materials from abroad, as well as of foodstuffs and of certain types of manufactured goods in which others specialise and for which there is a demand here. A *quid pro quo* must be secured in the form of agreements to take additional goods from us against our prospective increased purchases. This is essential if the vast improvement in the standard of living which the New Order will warrant is not to be seriously threatened. It is safe to assume that such a policy will be whole-heartedly supported by the statesmen of the world, as it will open up a way out of the prevailing deadlock and must redound to the benefit of the world at large as much

as ourselves. It seems scarcely conceivable, at all events, that any nation would passively acquiesce in the thwarting of an initiative aiming at the expansion, on a large scale, of international exchanges, and commencing with a concrete offer to purchase considerably increased quantities of goods as the basis for negotiation.

It is important that in the negotiations adequate consideration shall be given not solely to the interchange of goods and services, but to the discharge of current international obligations for interest, dividends, etc., due us in respect of past capital operations. These, in the aggregate, constitute a large sum, which is likely to grow constantly in future through resumption of capital investment abroad under the New Order, as described in Chapter 24.

Hitherto we have, in the main, allowed the trade balance with each country to find its own level, in the agreeable but futile expectation that, in all circumstances, current obligations arising from the use of our capital by foreign interests would somehow be forthcoming. The wholesale defaults of the last few years have taught us otherwise.

Through past errors in our foreign lending policy and other circumstances which it is not now within our power to alter, it will not be possible for our interchange of goods and services with every country currently indebted to us, in respect of interest and dividends, to be so moulded as to leave a sufficient margin of imports by us to permit the debtor country to discharge these obligations. Nor will it always be practicable, where there are no current financial obligations, to balance the interchange of goods. In such circumstances the negotiations above referred to must be extended to embrace groups of nations, the nature of whose combined foreign trade affords the possibility of being dovetailed with our own requirements of imports and markets, so that our aggregate interchanges with each group leave the necessary margin for meeting any current financial indebtedness on balance owed to us by the members of the group.

Our present foreign trade, visible and invisible, in the aggregate involves an excess of imports by us more than

ample for the discharge of all such current obligations in respect of remuneration on capital supplied by us in the past.

If there are any countries with whom our current trade is already balanced after allowing for financial obligations, if any, our larger needs of imports under the New Order will afford a welcome occasion for attempting to increase the interchange whilst maintaining the equilibrium.

So far as other countries are concerned, small groups of nations must be selected as above outlined, with each, and amongst all of whom, agreements would be negotiated under which the increased purchases we would make from some who are unable to give an adequate *quid pro quo*, in the form of larger imports from us direct, would be translated by those countries into bigger purchases from other members of the group, who in turn would undertake to augment their imports from us.

Thus we should build up a fabric of bilateral and multilateral treaties, which, in combination, would ensure equilibrium in our balance of payments and would result in our excess imports directly or indirectly benefiting our debtors. It is true that we should still have no assurance that our debtors would, in fact, use the means made available to them in this way, to satisfy their current financial obligations to us. Safeguards in this respect would, however, be introduced in the trade treaties with the debtor countries, to be implemented in case of necessity by clearing arrangements. In so far as the sterling resources required by the debtor countries to meet their liabilities to us on financial account are, in whole or in part, not provided by direct excess imports by us from the debtor country, but by indirect ones through group treaties, special arrangements would have to be devised to cover the contingency of the establishment of a Clearing. It would be stipulated that in this event the countries in the group which, in return for our additional imports from them, have undertaken to buy more from the debtor countries, shall to that extent pay for their purchases from the latter through the Clearing instead of direct to the debtor country.

As the New Order should ensure that, under all conceivable circumstances, the money equivalent of our purchases will, through good times or bad, not only remain stable but tend to rise, it would be inequitable if, as we had to do in the past, we were forced to stand helplessly by while the proceeds of our excess purchases were used by our debtors to over-import from elsewhere. Scarcely less objectionable it is to be expected to acquiesce in the distribution by debtors of the foreign exchange surplus we have provided for them, *pro rata* amongst all creditors, irrespective of the willingness or ability of these latter to continue to import from the debtor country on a sufficient scale to meet their share of its current financial obligations. Only the sacrifices and forethought involved in the New Order outlined in this book can render the maintenance of international trade at the highest level practicable in all circumstances for the country which adopts it, to the inestimable benefit of the world at large. It is legitimate and just, and in the interests of all, that the fruits should not be dissipated by the fatal *laissez-faire* attitude displayed in the past, to the disruption not merely of our own national economy but with fatal repercussions everywhere. Even those countries who prefer to continue in the old thoughtless way at the mercy of fluctuating price levels, booms and depressions, stand to gain by our ability under the New Order to continue our purchases abroad undiminished or to increase them, which would be impracticable if current financial obligations due to us ceased to be fulfilled.

One point will have to be remembered in our negotiations. Whilst during the rehabilitation stage of the New Order our present already excessive margin of imports over exports may temporarily still further have to be increased, so that a full *quid pro quo* for additional purchases will not be demanded, the time will come when strict equilibrium must be established. This will then mean a greater expansion of our exports than of our imports as compared with the preceding period. It would be well to face the implications of this inevitable development from the start, when our bargaining power will be greater than when the change-

over to a smaller margin of imports over exports is immediately impending.

Once the difficulties of ensuring that our international payments account shall be balanced—and this, on a constantly growing scale, will have been surmounted by patient and resourceful negotiation—the New Order will be free to consider the policies to be pursued in order to meet the old problems from which, as little as the present system, it will be exonerated : instability in price level of primary commodities ; and new inventions and technological improvements.

The difference is that the New Order will be equipped. to grapple with them and deprive them of their power to disorganise and ultimately destroy, as they are doing in many directions, the foundations of ordered economic existence. Whilst we cannot impose our New Order upon the rest of the world, it is bound to find emulation before long, and meanwhile, wherever it is operative, the means are available, not merely to insulate the national economy against destructive forces, but to enable the country to function as a stabilising and stimulating element in times of grave economic peril.

First let us briefly consider the reactions by our New Order to a severe decline in prices of primary commodities. Such a decline may arise through actual superabundance relative to demand in an unplanned world, or it may be brought about by restriction of consuming power consequent upon the barbaric operation of unreformed money economics in other countries.

Before the decline had gone far, or probably before it had set in, the portents would have been read by our planning authorities. The first step would be an attempt to gauge to what extent lower prices of imported primary commodities would tend to increase the volume of consumption, on the basis that no repercussions of the decline in prices adversely affecting domestic economic activity would be permitted to supervene. In all likelihood it would be found that the volume of consumption would rise, but not to the full extent of the drop in prices, so that

the total amount spent on imported goods might be expected to decline. In such circumstances it would not be practicable to maintain exports at their previous money level, and as the unit price of the exported goods would only very partially reflect the drop in price of raw materials, the volume of our exports would be adversely affected.

Confronted with this prospect the Economic Council would be called upon to devise means whereby the decline in the money value of our international interchanges of goods and services, and the unemployment to which the prospective falling off in the volume of exports would give rise, can be averted. It would anticipate these developments by planning to slacken the production of the export goods which it is expected could no longer be afforded by our customers abroad as a result of our smaller money purchases of their goods. The labour thus set free would be transferred to the making of goods requiring a larger volume of raw material import from abroad and in the main domestically saleable. Only to the extent of the expected drop in other exports would they have to be sold abroad. Thus the money value of our imports would be maintained and the volume increased, and, under our trade treaties, we should be assured of exports at the same level as before.

It would be a source of special gratification at such a time of falling prices to be able to enter world markets and negotiate for an increased volume of purchases, without having to ask more than that the previous money value of our export sales should continue to be taken. Not only would no disturbance be occasioned in our domestic economy, but greater abundance of the imported commodities we used would be permitted to have its natural effect of improving the standard of living. Furthermore we should be in a position to exercise a leavening effect upon international trade at a time when it was particularly needed. It may well be, of course, that the treaty provisions for clearing arrangements for the protection of our position in regard to current financial obligations owing us from abroad, would have to be made operative during such a period of declining commodity prices. This too should have

a wholesome effect by inspiring in our debtors respect for engagements, for the breaking of which there could in the circumstances be no justification.

Whilst the above lines could be readily followed in regard to raw materials and foodstuffs, in so far as they were non-competitive, they would not be appropriate if competitive produce were concerned. It is clearly imperative that our own agricultural industry should not be allowed to be disorganised and ultimately bankrupted by decline in world prices, through conditions which we could not control and which might easily have been avoided if other countries had been equally ready to submit to the self-imposed restraints of the New Order. An increased volume of imports of agricultural products would nevertheless be permitted to come in, limited to the extent by which it was estimated consumption would be increased by the stimulus of the decline in prices. This would be achieved by quotas. Moreover, the lower prices would not be reflected in farmers' income, as a direct subsidy, on a sliding scale based on market prices, would be paid to domestic farmers. The import quotas, instead of being lower than the volume negotiated for in the treaties, would be greater, though it is not certain that they would be equal in money value. If not, the effect upon exports would be met as above explained.

Whilst a decline in prices of non-competing imported produce entails no burdensome consequences in a planned economy under the New Order, it will be seen that superabundance of competitive commodities does raise a problem of the distribution of benefits and cost. The advantages are reaped by all consumers, and the benefit of low prices of agricultural produce is felt most by those obliged to budget closely. On the other hand, the subsidy is paid by those whose income places them in the taxpaying class and in greater proportion by those in the higher brackets of income, a not unreasonable distribution. Both the flow of money within the national borders and the value of the international interchanges remain unaffected.

A solution along different lines would have to be applied if, for any reason such as inflationary tactics, low standard

of living, subsidies in foreign countries, manufactured goods imported in competition with our own industry, were to become cheaper. In the first place, under the New Order, the attitude towards such imports would be different. Our foreign trade relations would be governed by treaties, and whilst these would be flexible and adjustable and the offer of goods at reduced prices from abroad could not be ignored, if only for its effect upon other markets where they compete with our goods, there would be no inherent right to import into this country other than by negotiation. We would look upon our foreign trade much in the same light as the head of a family would look upon income and expenditure of his household. He could surely not concede the right to every one of its members to order what they pleased and draw upon the joint resources of the household to foot the bills. He, and all his household, may be willing that their combined income should be pooled and fully re-spent; they may all unite in the effort to raise that family income to the highest possible level, but the limit of the expenditure must always remain the total of their several contributions to the income, and it must be co-ordinated so as to meet the requirements of each of the members in fair and due proportion. The tradesman who persisted in sending "on approval" attractive goods at tempting prices to the household after having been informed that the limit of the spending power of its members for his goods had been reached, would scarcely be encouraged by the responsible head of the family.

Clearly the old conception of international trade must make way for a new approach which restores to the community, represented by its responsible organ, mastery over the entire domain of these interchanges, to the end that they may be carried on at the highest conceivable level and in the channels most conducive to the national welfare, with constant expansion ever as the goal. Only so can we, in times of depression in other parts, maintain our prosperity and help to alleviate the hardships involved to other countries in such circumstances.

The answer, then, to the threat in the home market which

a decline in the prices of competitive manufactured goods would constitute, would be quotas and duties, not, however, lower but higher quotas than before, to the extent that the drop in price was estimated to result in stimulating demand. On the other hand, this would provide no remedy for the difficulties we should encounter in negotiations for renewal of trade treaties in other markets, in which our makers would have to meet the competition of the cheaper goods on equal terms. Of course, our position under the New Order, as an ever-increasing buyer, would still give us a great advantage, but it would not be well to rely on this alone. Creation of a demand abroad for other goods in which we were less vulnerable, so that they could be substituted for the exports in which we were being undersold, would be one of the policies to be adopted, and export subsidies, to be defrayed out of the special duties to be levied upon the competitive goods, should not be ruled out. Of course, the most energetic research and ceaseless vigilance, with a view to the constant improvement of methods and organisation, would be assured under the New Order.

Now let us turn to the implications of a general rise in imported commodity prices. Under the New Order this will not be a development eagerly to be welcomed.

It is not likely that we could promptly expect to increase our exports correspondingly to enable us to pay, without reduction in our foreign exchange reserves, for the same volume of imported raw materials, foodstuffs, half-manufactured goods, etc. Such increased exports should follow later, but it must be remembered that under the New Order there will be no surplus of labour to make additional goods for export. Hence our planning authorities will have to ensure adequate supplies of the raw material needed for our export goods and may have to cut down imports of other less necessary goods. In any case it must involve a reduction in the standard of living. There will be a lesser volume of goods to go round if our foreign trade accounts are not to be thrown into disequilibrium. This may set some labour free to work on export goods. The effect of increased cost of raw materials will, in time, raise the price of export goods, but

only to a minor extent, as other items in the list under a planned economy would vary little : interest would be low and stable, wages would not need to fluctuate much. Thus it may be anticipated that it will not be long before the diffusion of purchasing power in the primary producing countries will cause increased demand for our manufactured goods which will hardly have varied in price.

There is, of course, another answer to the increase in cost of imported raw materials—a reduction of leisure which under a planned economy would be ample. A relatively small addition to working time, without increased wage, would cheapen the unit cost of our output and counterbalance, if not outweigh, the increased cost of raw materials, and enable us more readily, by increased exports, to meet the cost of the former volume of imports at enhanced prices. Nevertheless this would be a retrogression in the enjoyment of the amenities of life.

Our initial policy of reducing imports when prices abroad rose would have had the twofold effect of acting as a brake upon the rise and of bringing home to our own people the true meaning of increased cost of imported goods.

It is interesting to note that, just as a decline in imported commodity prices enhances the standard of living under the New Order, so a rise causes it to deteriorate. This, of course, is the true reaction, but it is in contrast with the repercussions entailed by these phenomena under chaotic money economics as at present conducted. This arises from the fact that we now have a permanent large surplus of unemployed labour and the greater activity which rising prices involve consequently is regarded as a boon. The New Order has no unemployment and hence it cannot benefit from rising prices. Stability is its greatest asset.

The attitude towards new inventions and technological improvement is likewise altogether different in the Trustee State we envisage, from what it is at present. Instead of being regarded as a curse, as is now frequently the case because of the havoc wrought, they will be made to serve

the interests of the community. When the fundamental factors of economic existence are harmonised, as they will be under the New Order, all problems surrounding it are capable of rational solution, since they will be approached in a spirit of single-mindedness, seeking only to protect the community against possible prejudicial effects and making secure the benefits.

Under the New Order the only patentee of new inventions which will be licensed for use will be the Economic Council. All seekers of patents, after the fiat of the Patent Office has been obtained, must submit their applications to the Council. The latter, after thorough investigation and consultation, through the Central Board of Enterprise, with the interests concerned, decides whether or not it will accept the invention. If it declines the patent will be registered at the Patent Office for purposes of record only in the name of the inventor or his nominees, who will be free to sell it abroad if possible, but it cannot be used within this country. If the Council accepts the invention it will be registered in its name and it will indemnify the inventor on a mutually agreed basis, which may include a fixed annual stipend for life or for a period of years. If agreement is not reached the matter is to be submitted to a special Patents Arbitration Committee, whose decision is binding upon the parties. Once the invention is accepted by the Economic Council the likely effect of its introduction will be studied by a committee of experts which will report to the Council. The latter will determine, on the basis of the report, whether, and if so on what conditions, it is to be adopted. Any inventions released for utilisation by the Council will be available to all units in the industry concerned, subject to payment of royalties out of which the payments and stipends to inventors would be defrayed, the balance going to the State. Total production under the new process would be subject, of course, to the limits assigned through the Central Board of Enterprise to the Trade Association to which the makers or producers belonged.

If the invention is of a type which permits existing

commodities to be produced more cheaply, it will either permit economies directly or indirectly in wages per unit, whether it be through acceleration in the process of production or through lowering the cost of the materials used per unit. This will involve a lower dissemination of money per unit of the goods. Nothing is, of course, further from the truth than that the number of units turned over increases automatically in the same ratio as the cost per unit falls. The Economic Council, in the light of the data in its possession, will take steps to prevent the dislocation of industry and of employment attendant upon such inventions. It will consider the likely increase in volume of sales as a result of the reduction in price, the extent to which wages paid in the industry directly itself involved and in the industries supplying its raw materials will be affected; in how far such raw materials are imported from abroad, etc.

Assuming the Council came to the conclusion that some increase in demand for the goods cheapened by the invention would be likely, but that in the aggregate a lesser volume of money would be spent upon them, it would be necessary to find other uses for the labour which would be displaced. If the raw material for the goods concerned is imported, the increased turnover may involve greater imports, though not necessarily so if the invention related to economy in use of raw material. Furthermore, the new goods to be made by the transferred labour may require additional imports of raw material, so that on balance commodity imports are likely to be larger. A *quid pro quo* would have to be negotiated for our increased imports, and a part of the new goods made should, therefore, find a market abroad whilst the remainder should be such as would be saleable at home.

Inventions in the above class which would be immediately most beneficial would be such as would permit of a wider and more economical use of our own scanty natural resources, or that would improve the efficiency of industries in which we had reached a certain world pre-eminence.

It is conceivable that there may be circumstances in

which the Economic Council might determine that it would be preferable to defer utilisation of the new invention pending the removal of obstacles to its assimilation. This course would, however, not be lightly decided upon if the invention was capable of being utilised by competitors abroad.

There is another kind of invention which affords the means of creating new types of goods out of existing materials or new materials out of products hitherto unutilised. Such inventions may become added sources of wealth, but it must not be overlooked that in a planned State there is no surplus of labour. Hence the time to be devoted to the making of the new goods or materials would involve curtailment of work on other things. The Economic Council would thus have to investigate whether and to what extent the well-being of the people would be enhanced by the new processes. To a large extent this would resolve itself into a study of human wants at home and, if the goods are suitable for export, abroad also. The community cannot have more in the aggregate than its members combined can create of goods and services. If they are creating all they are capable of, then it becomes a question of what we can and will do without if we wish to have something new. If the new invention enables something to be made which, for the same volume of dissemination of purchasing power, provides goods that give greater enjoyment than the similar goods previously produced, production will have to be adjusted to meet the change in venue of purchasing power which the invention will bring about. In practice, however, the effects will hardly be as simple as this and the Economic Council would be called upon to gauge the manifold rearrangements both in international interchanges and domestic production that would be entailed.

Thus inventions would become the boon to the community which they are meant to be, without the transition stage of dislocation and suffering inherent in the existing order, and inventors would have an honoured place in the community. Nor would the benefits be confined within the national borders. They would be diffused abroad through

productive power set free here, which would increase our capacity to interchange goods with foreign countries. No longer would an increase in productive power anywhere be looked upon with fear and misgiving if, throughout the world, such planning were in operation. But we need not wait for the rest of the world. We can give the lead, and there can be no doubt that we shall find counterparts mutually advantageous for the bargains we shall be able and willing and anxious to make.

A problem that arouses considerable feeling is that of the destruction of goods with a view to attaining or maintaining a price level at which producers are protected against the prospect of insolvency. It is necessary, however, to view the question without preconceived notions and above all free from the generalisations of ignorance.

That destruction is a wasteful method is undeniable. That there are circumstances in which it may prove effective cannot be gainsaid. The claim made by enthusiasts for a barter economy that such procedure is unthinkable if money were eliminated from our considerations will not stand a moment's reflection, except if a barter economy becomes synonymous with the dispensing of charity. If, for instance, fish under a barter system were landed at a seaport where only a fraction of the catch could be consumed, the bulk would have to be transported elsewhere. Assuming the railways, which would have to be paid in kind, required more to carry it than the whole of the fish transported or than the whole of the goods which at destination could be obtained for it in exchange, then it is difficult to see how even a return to the trading methods of the dark ages, which surely barter involves, could leave any other choice but destruction or free distribution.

It needs no emphasis that nothing can be further from the aims of the New Order—under which anyway money is relegated to its proper place as a counter—than acquiesce in needless squandering of God's bounties. In exceptional circumstances it may be deemed expedient to subsidise the transport of goods or otherwise to assist an industry in order to prevent its decay, provided it is of sufficient importance

to the national welfare. There is no inherent difference between subsidising the transport of fish and paying bounties to farmers, which latter have already become a feature of our present-day economy.

There are, however, circumstances in which destruction is the only rational method so long as the New Order is not adopted in all the chief countries of the world. In principle, agreements to curtail production aim at the same effect: the withholding of supplies from current consumption.

Quite dispassionately considered the destruction of perishable goods for which there is, for the time being, inadequate demand is, in one sense, more beneficial. The production of the goods destroyed has disseminated purchasing power which is now released for concentration upon other goods. Thus it achieves simultaneously a reduction in supplies of the particular commodity and a relative increase in the proportion of commodity money available for goods to be absorbed. This the restriction schemes do not do. In so far as production is curtailed no purchasing power is diffused, so, in fact, it directly imposes sacrifices and a reduction in the circuit flow of money, but compensation is found in the confidence inspired by the adjustment and prices are helped by the purchase of goods with money previously idle or circulating amongst securities, etc., as fully described in earlier chapters. It does not follow that destruction is, in principle, to be preferred. Restriction, in most cases, conserves the resources themselves, and this, in the case of minerals, for instance, and produce taking years to mature, is obviously indicated.

The Government, under the New Order, should always be ready to consider participating in and supporting international action, capable of being adequately enforced, for ensuring profitable production of raw materials, so long as the interests of consumers and public in general are fully safeguarded and the arrangements do not serve to divert an undue proportion of the money distributed in the process of production and distribution of goods to any section outside of the jurisdiction of the New Order, in the form of profit on commodities so assisted and sold to us. Within

our borders such profit is directly, or through the National Investment Trust, restored to the commodity money flow. Elsewhere, however, there would be no assurance that those high profits would be used to acquire goods, nor that purchases from us would be increased so as to permit us to pay the higher prices asked for the commodities.

In the problem of destruction of produce our Government is not likely ever to be directly concerned. It is one affecting in the main producing countries of staples bearing annually.

Far more desirable from every point of view, humanitarian as well as economic, would be co-operation between nations, whenever abnormal surpluses of perishable commodities were accumulating, with a view to sharing in the cost of internationally financed redistribution arrangements. These would involve the transportation of such part of the surplus as would not be needed as an equalisation supply which it may be considered prudent to lay up, to places where normally supplies would not be available at all and where they would be distributed free amongst the needy. The stimulating effects of the circulation of money spent on transport, and of the removal of excessive supplies, would in themselves be highly desirable corollaries, but apart from this, demand would be engendered in foreign parts for goods previously unknown there. With greater diffusion of purchasing power this would, in time, bring tangible results on a larger scale. In a wider sense, the effect upon human relationships would be truly miraculous. Nothing could do more in a practical way to convince the beneficiaries that the brotherhood of man was a reality. Christian economics are not Utopian dreams; they are a paying proposition. What we give comes back a hundredfold, as Our Lord teaches—but giving with right motive must come first.

Although nowhere has a general planned economy so far been adopted in conjunction with money economics conducted along lines set out in this book, yet sectional planning in times of depression has been resorted to almost everywhere and is likely to be repeated, since slumps are

inevitable so long as the existing system prevails. That planning consists in the laying up of stores, the formation of pools in years of unsaleable surplus, combined with restriction of area under cultivation where such measures are capable of being enforced. There seems nothing intrinsically wrong in making provision for lean years in the fat ones. The New Order, however, goes much further and is directed towards eliminating within the national borders any features of money economics which paradoxically now render the fat years the germ-carriers of an epidemic of depression and creeping paralysis. Under the New Order our national economy, instead of being infected by this devastating process and perforce becoming a factor accentuating its virulence, will, on the contrary, be in a position to preserve robust health itself and actively contribute towards the alleviation of the hardships suffered by others through expanding the volume of its consumption.

If, in the approach to problems of world economics, the New Order has defences not available to States in which money economics rule uncontrolled, it is also infinitely stronger, because completely homogeneous, in dealing with the internal aspects of its economic existence.

Since the capitalist structure will be retained under the New Order, it is unavoidable that the abuses attaching to that system will be inherited with it, even though their scope will have been materially narrowed down.

The New Order, however, in its assault upon the bastions of dishonesty, greed and exploitation, will be able to count upon the powerful unifying force of identity of interest that will prevail amongst the members of the community. All will be shareholders in enterprise through State ownership of the National Estates and, to an ever-increasing extent, indirectly as investors in the National Investment Trust, whereas under the existing system only limited numbers are personally concerned with capitalist finance.

It is the inevitable delegation of actual control of enterprise to the relatively few, inherent in the joint-stock principle, which leaves the door wide open to abuses. One

of the domestic tasks to be taken in hand promptly under the New Order will be the introduction of effective measures to stop the gaps left by inadequate company legislation.

Manipulation of accounts through affiliates, subsidiaries, holding companies, etc., of which no figures are published, which are frequently incorporated as private companies, and the balance-sheet dates of which, in any case, are not necessarily synchronised with those of the parent companies, must be put an end to. Any public company which has a capital interest in any other, whether a private or public company, over whose management it exercises influence, directly or indirectly, will be obliged to publish the accounts of such concern together, and synchronised in date, with its own. If any such affiliated concern, in turn, has any similar interests the parent company must likewise include the accounts of the sub-affiliates. Where a public company owns, directly or indirectly, the whole or the bulk of the share capital of any enterprise, it must, in addition, publish a consolidated balance-sheet.

Furthermore, the scandal of speculation in and manipulation of shares through nominees must be abolished. Securities may be registered in the name of nominees only when coupled with the name of the actual owner. Any secret agreement purporting to vest ownership in any person not the actual owner is void, and the parties registered with the nominees will be regarded in law as the owners without further proof. Any violation of the registration provisions will entail forfeiture of the securities to the National Estates and other penalties, both for the actual owner and his accomplice. Thus the secret exploitation by directors and their friends of information gained in their capacity as trustees for their shareholders is likely to become a very hazardous game, and, moreover, will expose them to denunciation by anyone aware of the facts.

Gifts to political parties with funds belonging to the shareholders and without the express prior consent in writing of every individual shareholder will be illegal,

and auditors who permit such gifts to be included in expenditure will render themselves liable to prosecution.

Speculation in commodities for future delivery by parties not engaged in the trade will be permitted only against deposit in escrow of 100 per cent in cash or securities. Members of the trade will have to provide margins in cash adequate to ensure that no speculation on any substantial scale could be indulged in.

Multiple voting rights, whereby power in enterprise is divorced from financial interest without express agreement of the shareholders, and whereby oligarchies are created and perpetuated in business concerns, will be circumscribed so that the holdings of securities which the National Estates will, in due course, inherit and those which the National Investment Trust will acquire, shall not be harnessed with disabilities in respect to voting rights. Without such provision it might be possible, by gifts amongst the living, of the shares carrying the multiple voting rights but representing only a small investment of money, permanently to deprive the community and the National Investment Trust of due influence upon the affairs of the enterprises concerned.

There will, of course, be many other aspects that will demand action. It is not to be assumed that the New Order will be able to cure all abuses in one stroke. It affords a soil, however, in which evil, at least so far as the financial field is concerned, cannot readily prosper, since most of its strongholds in our existing money economics will have been demolished.

There are under this New Order, operated by a nation of Trustees, no fundamental disharmonies. It is in a position to prepare the way in advance for dealing with its problems as they arise, and in the full consciousness that no feature of money economics can any longer set at nought the policies adopted in the economic sphere.

When the shackles of the prevailing system, impotent to prevent recurrent depression, reacting only when the situation has become desperate, have been cast off, it will be possible to consider the problems of material existence

in their true perspective. The vital question of population will appear in a different light. Is it not the dull resentment, the deep brooding despond, engendered by an order perpetually overshadowed by the seemingly immutable prospect of misery and want, at the root of the senility creeping in upon us, by depriving a large section of the community, at least, of the desire to propagate? With these economic fears removed and international peace fostered by the fillip imparted by the New Order to international commercial intercourse, the atmosphere will again become conducive to the stimulation of human reproduction.

Not falling numbers but teeming millions is what the New Order will require.

CHAPTER 30

NEW MEN

IN this final chapter a few observations must be devoted to certain grave problems not immediately connected with reform of the financial and economic order. They have their nucleus in the spiritual domain. Yet through their repercussions upon political destinies they pervade every sphere of existence.

They centre round the fanatical determination with which adherents of revolutionary political ideologies, for the time being dominant in their respective countries, seek to propagate and impose their creeds beyond the national borders.

The fierce antagonisms in consequence aroused between them are the more bitter for that there is fundamental identity in method: tyranny, oppression and persecution. The most savage and most irreconcilable enmity is invariably that between members of the same family. It is easy to conceive, then, the fiendish hostility with which family feuds amongst the house of Beelzebub are waged.

The suppression of free speech and press in large areas of the world is another distressing manifestation of the violence which is being done to the spirit of mankind made in the image of God. At the same time, under dictatorship, authority does not shrink from using all available means of publicity now made subservient to its will, to abuse and taunt other nations who have incurred its displeasure, with a licence unparalleled in diplomatic history.

These distressing features concern us intimately. Their baneful influence is not confined to the sphere of international relationships, but strikes at the root of economic existence and of life itself. As yet there is little danger here of widespread infection by those foreign creeds. However, the inevitability of recurrent depression under the existing

order renders us susceptible, and already the spiritual outlook from which they spring has found emulators and propagators here. This has brought some of the problems that agitate the world right to our very doors. Whilst dictatorships permit no other distortion of the spirit of their nationals by publicity than that sanctioned by themselves, the corresponding problem in democracies is to protect the community against the injury inflicted by abuse of freedom.

In the modern world, with its unprecedented facilities for mass approach, the dangers of the propagation of evil through the poisoning of the minds of the unprincipled, the unstable, the ignorant and immature, have become infinitely more virulent. We must ensure that our treasured possession of freedom of speech shall not be made a cloak for abuse, revilement, lies and provocation. Like the freedom to deal with our money and our property, it must be restricted at the point where it becomes synonymous with licence to inflict harm upon the community or any law-abiding section of it.

The ideal that inspired past generations to lay down their lives for the attainment of free speech, viz. the winning of the unchallenged right to uphold views on any subject conflicting with those represented by constituted authority, must not be permitted to be abased into a travesty. The impunity that rightly covers the genuine critic of authority now extends to the reviler in any attack he chooses to make upon any section of the community that arouses his wrath, his prejudice or his predatory instincts.

Unless democracy crushes this grave menace, parading under the guise of one of its most cherished and inalienable attributes, there can be little hope that constitutional democracy will survive.

The Jewish question too has been transplanted to our shores by systematic attempts at persecution and defamation and pandering to the vilest impulses in man.

The impression, widely spread and frequently used to stir up evil passions, that Jews control vast international money power working for sinister ends is a pure phantasy.

Neither in this country, nor in the United States, do Jews cut much ice in the financial world. There are, to be sure, a few Jewish finance houses, but they are completely overshadowed by the great deposit banks in which there is no Jewish influence, and by the larger, more influential, much better conducted banking houses and private banks owned by non-Jews.

It is different in Central and South-Eastern Europe. There a large proportion of banking and financial business is in Jewish hands. Their influence is, however, confined to those regions, and there never was the slightest foundation for the suggestion that Jews had a stranglehold on finance throughout the world.

Even though an antithesis may instinctively be felt to exist between the ethical conceptions of some Jews and those held by the society amongst which they live, that barrier can never be broken down by inflaming hatred against the Jewish race merely because its members happen to be what God has made them.

To my shame I admit it, there was a time when I felt a violent antipathy against Jews akin to that of Hitler, although I am myself of Jewish origin. Not that I ever desired to harm anyone personally, but ever since early youth I experienced a strong aversion to a mental outlook and an appraisement of ethical values with which I considered I had nothing in common. Looking back the years now, I am convinced that fear played a big part in those sentiments; the fear of being identified with Jews. Later I realised the grave wrong, the unbounded arrogance towards God, which my attitude involved. Full of sin and iniquity myself, I claimed to usurp God's right to sit in judgment upon others. I hope I may receive forgiveness from God. I pray also that the day may come when Hitler, for his own sake and that of the world, may come to recognise how grievously he must wound his Master by defiance of that great commandment which our Lord Jesus gave us: "that ye love one another even as I have loved you". How deep would be His joy if He beheld one called to exalted state in the world consecrate the unrivalled opportunities

and gifts bestowed upon him to the furtherance of God's Kingdom on Earth, instead of permitting any of these to be dissipated on the gratification of a lust: that of inflicting suffering and humiliation upon other human beings. My prayer ever is for him and for all the rulers of this world that they may be rightly guided by God in all their acts and decisions, so that the spirit of neighbourly affection, helpfulness, generosity, willingness to sacrifice for the sake of our fellow-beings may ultimately prevail amongst the nations on this earth. Nations in their conduct towards each other, in the last analysis, must reflect the spirit which animates the individuals of which they are composed.

Hatred of sin in others is an attitude pleasing in God's sight only when it has first been energetically directed to the eradication of sin in ourselves, and when it is inseparable from love for the sinner whose regeneration should be our sole aim, not his doom.

How appalling, in the light of the divine Spirit, must appear the hatreds, the persecutions, oppression, fratricide, the taunts, the threats and counter-threats, which loom so large in the world.

Has the New Order an answer for these disastrous developments? Some of the fundamental causes will certainly be removed by the reform of the financial and economic system which is its aim. Through its introduction, revitalising and regenerative forces will be released in the domain of international relationships. Moreover, by eliminating conditions directly conducive to the spread of evil, by rooting up incentive and by prevention it will powerfully restrain wrongdoing.

Without new men—and women—however, the New Order could not come into being. Who are they and where are they to be found? They are the same men and women we know and who live in our midst. Now intent upon their individual pursuits they will unite to a common purpose, Christian reform of the economic and financial order.

They believe in God and love Him sufficiently to be willing sharers with Him in bearing the grief that misery

and want amongst His children must inflict upon Him.

They realise that no economic and financial order can be lasting which, in its treatment of man by his fellow-beings, is at variance with that which a loving Father, who loves all His children equally, yet has created each a different personality, desires to see meted out.

They have seen the fate that is overtaking such an order everywhere. Though for the time being it is superseded by other systems, in some respects even further removed from His will, this can only be a step in the fulfilment of the Eternal Purposes which God is working out ceaselessly for this His world, and which are not accomplished until His everlasting dominion is established.

They ask nothing better, those men and women, than that they might be used by God in the great work of making this world more akin to His Kingdom. They are undeterred by the sacrifices it will entail, for they derive their strength from that Life of supreme sacrifice, that Life transcending death, which was spent for us by Jesus, in complete obedience to the Father, in utter selflessness and unswerving love and loyalty to mankind. Not enough for them is the shelter and comfort which Faith bestows. That faith must be stirred into the living and life-giving force which submission to dictatorship of God can achieve.

There must be amongst my readers some who have no faith in God, or at least not in the God revealed to us by Jesus Christ, but who are nevertheless in sympathy with the proposals for a New Order contained in this volume.

In the establishment of the New Order, Christian love and enlightened self-interest are destined to go hand in hand.

Whatever creed men may profess, they must be conscious of the impotence of mankind in all that pertains to the creation of life. If they were asked to define the attributes which a supreme life-giving being must possess to whom *they* would be prepared to give allegiance, to whose commandments they would be prepared to submit themselves, is it possible that he could be more loving, more lovable than our Lord Jesus Christ ?

Perhaps they seek a god who removes all sufferings and injustice from this world without their having to make any personal effort towards that aim. Such a god would bring down humanity to the level of an automaton. It is not the God whom believers know, who, though He permits suffering, ever suffers with us, and when we seek Him and call upon Him, by His indwelling presence ever strengthens and comforts us and gives us power to overcome. It is not the God who places mankind on the same divine plane as Himself calling upon us to strive to be perfect " even as your Father in Heaven is perfect ". Obedience to Him is indeed a privilege to be striven for !

" The surrender of the whole life to the sway of Jesus Christ : the quiet daily lifting of the life in renewed loyalty to Him, seeking only to do His will : the fellowship with others in which we share what we have found, both getting and giving help, particularly in seeking to win others to Him who have no living experience of Him—these things release a power and energy into human lives that have no parallel." [1]

Even though this solution is not vouchsafed to unbelief, yet no one can be blind to events around us.

Is it possible to contemplate the pass to which the world has been brought without the conviction that only a return to the ways of God can bring hope of relief, without shuddering at the thought of what may yet be in store if the yoke of God that leads to Life Everlasting continues to be rejected in favour of the death-grip of the powers of Satan ?

If we confine our vision to this country we cannot help recalling the narrow margin by which we escaped a breakdown of the social order in 1931. There is no room for any illusion as to the political consequences of the next depression. That there will, under the present system, inexorably be a next depression, this study of our existing money economics will, I trust, have amply demonstrated.

No infallibility is claimed for the New Order proposed to take the place of the old. It is no doubt capable of being

[1] Leslie D. Weatherhead, M.A., *Psychology and Life*, p. 162.

supplemented and improved upon. The broad lines on which it is based, however, cannot be deviated from without destroying its effectiveness. With scrupulous regard for the property and legitimate acquisitions of the living, and the least possible interference with individual liberty, it leaves the fullest scope to initiative, energy, brain power, organising talent. It demands the sacrifice only of such rights as must be centralised, and exercised in the interest of the community as a whole, if the latter is to be protected against the injury which uncontrolled action has inflicted upon it in the past.

Unless the reform proposed is promptly taken in hand, the changes that will eventually be forced upon us will scarcely be inspired by the motives or the precepts on which the New Order here outlined has been built.

A final word before we meet again on the field of action for the establishment of the New Order. Let no one think or allow himself to be persuaded that he or she is too unimportant to matter in the scheme of things. It is a lamentable excuse by which Satan lulls us into complacency and indifference to the sufferings, the injustice, the oppression around us. We should ask ourselves always whether our ideas, our actions or our failure to act, if they were shared by all in similar circumstances to ourselves, would make this world a better or worse place for the community as a whole. We must never believe that we are powerless; no one is who submits to the guidance of God and follows it. What we must be certain about is that our motives are pure. No thoughts or acts can emanate from the Holy Spirit that include the initiative of violence or spoliation; nor could He countenance vindictiveness and revilement. Unless they reflect love in its highest form—pure and unselfish—they are not of God. Our own human standards, however benevolent they may appear, can never be allowed to take the place of those revealed to us as God's.

Only by rallying around the common banner, the banner with the Cross and the pierced body of our beloved "Brother"—for so we may call Him if we love Him—can we turn back the menacing tide of chaos.

Let us end with a prayer:

Prayer [1]

O God, the Father of the forsaken, the help of the weak, the supplier of the needy, Who hast diffused and proportioned Thy gifts to body and soul, in such sort that all may acknowledge and perform the joyous duty of mutual service; Who teaches us that love towards the race of men is the bond of perfectness, and the imitation of Thy Blessed Self; open our eyes and touch our hearts, that we may see and do, both for this world and for that which is to come, the things which belong to our peace. Strengthen us in the work we have undertaken, give us counsel and wisdom, perseverance, faith and zeal, and in Thine own good time, and according to Thy pleasure, prosper the issue. Pour into us a spirit of humility; let nothing be done but in devout obedience to Thy will, thankfulness for Thine unspeakable mercies, and love to Thine adorable Son Christ Jesus, Who with Thee, O Father, and the Holy Ghost, ever liveth one God, world without end. Amen.

[1] By Antony Ashley Cooper, Earl of Shaftesbury. A.D. 1801. From "A Chain of Prayer across the Ages", compiled and arranged for daily use by Selina Fitzherbert Fox, M.D., B.Sc.

GLOSSARY OF SOME ECONOMIC AND FINANCIAL TERMS

WITH DEFINITIONS OF THE SENSE IN WHICH THEY ARE USED IN THIS BOOK

A

ASSETS.—Money and possessions, tangible and intangible, capable of being exchanged for money, except such as, in the hands of the possessor, serve for individual current use or consumption.

Thus petrol, owned by the garage proprietor for sale to the public, would fall under the definition of assets, as the term is employed in this book, but when it has passed into the possession of the motorist for use in the running of his car, it becomes an article of current consumption. Furniture, to the dealer, is an asset, to the householder an article of current use.

Pictures, possessing a market value, however, would be termed an asset both when part of the stock-in-trade of an art dealer or when privately owned.

Tangible assets include, for instance, goods, plant, securities, houses, etc.

Intangible assets include, for instance, goodwill (*i.e.* profit-earning capacity), business experience, craftmanship, etc.

ASSETS, CAPITAL.—Assets capable of returning an income without personal labour by the owner.

Thus assets constituting the means of production of goods and services, also land, buildings, securities, bank balances, fall under this definition. Tools, on the other hand, would not rank as capital assets, but installations or equipment sufficiently comprehensive or of a nature to enable the owner to obtain a rental for same if desired, would be classed as capital assets. (*See* CAPITAL.)

ASSETS, CURRENT.—Assets not falling under the definition of capital assets, currently used in or originating in connection with the business of enterprise, *e.g.* tools, materials, stock-in-trade, trade debts owing to enterprise.

ASSETS, LIQUID.—Money and assets readily exchangeable for money, such as certain types of securities, staple commodities, etc.

B

BANK CREDIT.—Credit balances created by members of the banking system in favour of borrowers, mostly against security pledged

to the bank. The right to use such credit balances is granted to the borrower by the bank for a fixed or indeterminate period, as may be arranged.

BANK DEPOSITS.—*See under* D.

BANK MONEY.—Bank deposits.

BANK OF ENGLAND POLICY.—The exercise by the Bank of England of the prerogative to buy or sell securities for its own account with a view to expanding or contracting that part of the reserves of the banking system which is represented by balances at the Bank of England owned by the banking system (bankers' deposits).

BANK POLICY.—The exercise of the prerogative of the banking system to buy or sell securities for its own account with a view to expanding or contracting its deposit liabilities.

BANKERS' CASH.—Bankers' deposits (at Bank of England).

BANKERS' DEPOSITS (at Bank of England).—Deposit liabilities of the Bank of England in so far as represented by balances owned by banks and bankers.

BANKING SYSTEM.—The deposit banks collectively.

BOOK CREDIT.—Credit granted as between non-members of the financial system, chiefly in respect of goods or services supplied.

C

CAPITAL.—

1. Surplus income, past and current, not spent by recipient of the income upon goods and services for current use, consumption or enjoyment.
2. The capital assets (which see) representing the capital as defined under 1.

CAPITAL, WORKING.—Money and other assets of enterprise readily convertible into money or due to be received in money within limited period.

Working capital is adequate in the measure that it serves fully to meet, as they fall due, liabilities arising from the current conduct of the business of the enterprise.

It is redundant in so far as the amount on the average available in money at all times substantially exceeds maturing liabilities.

It is inadequate to the extent that current maturing liabilities normally exceed the money available to meet them.

CAPITAL ASSETS.—*See under* A.

CAPITAL OF ENTERPRISE.—Accounting term, denoting when used in reference to—

1. *Joint-Stock Enterprise:* the amount of the liability to shareholders (share capital) plus that to holders of bonds, debentures or other forms of long-term indebtedness (loan capital), if any.

2. *Partnership:* amount of aggregate liability to the partners, not including funds temporarily loaned to the enterprise by the partners.
3. *Non-Joint-Stock Enterprise owned by Single Individual:* difference between value of assets of the enterprise and its liabilities other than to the owner.

Note 1.—In the case of enterprise falling under groups 2 and 3, creditors will, apart from the capital, have regard to the net capital of the active partners or owners outside of the enterprise, seeing that the liability of such partners or owners for the debts of the enterprise is unlimited.

Note 2.—In the case of enterprise falling under groups 1 and 2, we must distinguish between nominal capital and real capital.

Nominal capital in the case of joint-stock enterprise is the amount shown on the books of the enterprise as the liability in respect of shareholders' capital (nominal share capital). In the case of a partnership it is the liability to partners shown on the books in respect of partners' capital (not therefore including loans made by the partners).

Real capital is the liability in respect of shareholders' capital or partners' capital as determined by a valuation of the assets, from which is to be deducted the total of the liabilities, including long-term indebtedness, if any. When the real capital thus arrived at shows a surplus over the nominal capital, that surplus represents reserves. Any deficiency would represent loss. If such deficiency was greater than the nominal shareholders' or partners' capital, the amount owing to creditors, including any in respect of loan capital, would not, in the aggregate, be fully represented by assets. Whether any particular creditor or category of creditors was, nevertheless, fully covered would depend upon the position in regard to security and priority of claim.

CAPITAL EXPORT.—

1. Action of capitalists, large or small, who with deliberate intent and regardless of interests of country to which capital is transferred, exchange assets owned by them in the country where they are domiciled, and representing capital to them, for assets abroad owned by foreign interests.

   Such export of capital may take the form of physical transfer out of capital exporting country of the assets representing the capital exported. Only goods—including gold—are assets capable of being so transferred. Goods are rarely used for the purpose except where obstacles are placed in the way of other types of capital exports.

2. Counterpart of a capital import (which see) deliberately undertaken by interests abroad requiring the use of capital. The operations involved by capital exports of this type are similar to those defined under 1, but goods in this case are a current form of physical transfer of such capital exports.

CAPITAL GOODS.—*See under* G.

CAPITAL IMPORT.—

1. Action by private or public interests deliberately undertaken in a country requiring the use of capital, involving the cession of capital assets in or of their own country (securities, bank balances, participation in enterprise, land, etc.) to foreign interests in exchange for assets abroad. Normally the assets thus acquired abroad by the interests in the capital importing country will consist of bank balances representing capital to their previous owners. These bank balances will then be utilised by their new owners in the capital importing country to pay for the assets needed, which, in most cases, will consist in goods to be physically transferred to the capital importing country.
2. Counterpart of capital export (which see) undertaken abroad without reference to the capital needs of the country to which the capital is exported.

   Such capital imports involve the incidental cession to foreign interests of capital assets in the capital importing country, and corresponding acquisition of capital assets abroad by interests in the capital importing country.

CAPITAL MIGRATIONS : CAPITAL MOVEMENTS.—Capital imports and exports when of substantial volume and persistence.

CAPITALIST SYSTEM : CAPITALISM.—System under which no restriction is placed upon volume of capital assets which may be acquired by individuals during their lifetime.

CASH.—Currency and specie.

CASH, BANKERS'.—*See under* B.

CASH RESERVES.—Cash held to meet current liabilities.

CENTRAL BANK.—Bank enjoying sole note-issuing privilege.

CHEQUE MONEY.—Bank deposits subject to withdrawal by cheque.

CIRCUIT FLOW OF MONEY.—The changes of ownership of money resulting from the interchange of goods and services and from the settlement of all other transactions involving payment, both within a country and as between interests in that country and interests abroad.

CIRCULATING MEDIUM.—Means of payment freely accepted and passing from hand to hand in the settlement of current transactions, *e.g.* currency and specie.

COLLATERAL SECURITY : COLLATERAL.—Security for loan in addition to other security given to the lender. In practice generally realisable assets pledged to the lender apart from the obligation entered into by the borrower to repay the loan.

COMMERCIAL CREDIT.—Credit granted to finance commercial transactions.

COMMODITIES.—Goods.

COMMODITIES, PRIMARY.—Principal foodstuffs and raw materials for industry.

COMMODITIES, STAPLE.—Primary commodities having world market.

COMMODITY MONEY.—Term used in this book to denote money created by the banking system in response to demand for commercial credit and existing bank money (bank deposits) when employed in turning over goods and services.

CONSUMPTION GOODS: CONSUMER GOODS.—*See under* G.

CREDIT, BANK.—*See under* B.

CREDIT, BOOK.—*See under* B.

CREDIT, SELF-LIQUIDATING.—Credit granted for the financing of commercial transactions, the liquidation of which is intended to provide the means of repayment of the credit.

CREDIT CONTRACTION.—

1. Action of financial system involving reduction of aggregate volume of deposits through sale of securities to the public by the financial system for its own account. *See* BANK POLICY; BANK OF ENGLAND POLICY.
2. Reduction in aggregate of deposits of banking system as an outcome of contraction of the aggregate volume of loans, whether such contraction is brought about at the initiative of the banking system or of the borrowers.

CREDIT EXPANSION.—

1. Action of financial system involving increase in aggregate volume of deposits, through purchase of securities from the public, by the financial system for its own account. *See* BANK POLICY; BANK OF ENGLAND POLICY.
2. Increase in aggregate volume of deposits of the banking system resulting from an increase in the aggregate volume of loans. Whilst in the main the initiative in such expansion rests with borrowers, the attitude of the banking system towards demand for such additional credit is the determining factor.

CURRENCY.—Paper money of legal tender.

CURRENCY, MANAGED.—Money the value of which in terms of the moneys of other countries is controlled by Central Bank or other central authority.

CURRENT ACCOUNTS.—Balances in the banking system subject to withdrawal by their owners at any time without notice.

CURRENT ASSETS.—*See under* A.

CURRENT GOODS.—*See under* G.

CURRENT INCOME.—*See under* I.

CYCLICAL TREND.—Characteristics of stage in trade cycle (which see) for which economic developments appear to be headed for the time being.

D

DEFLATION.—Process involving contraction of the volume of money in relation to the volume of goods to be absorbed, thus bringing

about an appreciation of the value of the money of a country in terms of goods.

DEPOSIT ACCOUNTS.—Bank deposits (which see) not subject to immediate withdrawal by cheque by their owners.

DEPOSIT BANKS.—Joint-stock banks accepting deposits from the general public.

DEPOSIT MONEY.—Bank deposits.

DEPOSITS.—Liabilities of members of the financial system (which see) to owners of credit balances in the books of the system.

DEPOSITS, BANK.—Liability of the members of the banking system (which see) to owners of credit balances in the books of the banking system.

DEPOSITS, BANKERS'.—*See under* B.

DEPOSITS, TIME.—Deposits which the owners have agreed not to transfer to anyone else during a specified period.

DEPOSITS AT NOTICE: NOTICE DEPOSITS.—Deposits which the owners have agreed not to transfer to anyone else without giving to the depositary the previous notice provided for.

DEVALUATION.—Process of decreasing the value of the money of a country in terms of gold or in terms of the money of countries whose money bears a fixed relationship to gold.

E

ENTERPRISE.—Undertakings engaged in the production and distribution of goods and/or services for profit.

ENTERPRISER: ENTREPRENEUR.—Person entitled, through ownership of capital, to all or part of the net profit of enterprise, whether such person is or is not actively engaged in the conduct of the enterprise concerned.

Where it is desired specifically to indicate enterprisers whose title to net profit arises solely from ownership of capital the term " owner-enterpriser " has been used.

EXPANSION OF CREDIT.—*See under* C.

EXPORT OF CAPITAL.—*See under* C.

EXPORTS, INVISIBLE.—*See under* I.

F

FINANCIAL MONEY.—Term used in this book to denote bank money (bank deposits) created by members of the banking system as the outcome of purchase of securities for their own account, and to existing bank money when employed in turning over existing capital assets.

FINANCIAL SYSTEM.—Bank of England and deposit banks collectively.

G

Goods.—Used to cover all articles of commerce capable of being conveyed in or on means of transport. Buildings or ships are thus not goods, but the articles going into their construction are goods.

Machines are (capital) goods, but plant in the sense of an entire factory installation is a collective term covering several descriptions of goods. Rails and rolling stock are (capital) goods, but a railway, *i.e.* the permanent way, is not.

Houses, ships, plant, railway, etc., fall under the definition of capital assets (which see). Some capital goods may represent capital assets, but few capital assets fall under the definition of goods.

Goods, Capital.—Durable goods representing capital assets, or destined to form part of or serve in the exploitation of capital assets, such as structural material, installations, equipment, rolling stock, machinery.

Goods, Consumption: Goods, Consumer.—Goods exclusively or chiefly intended for consumption, current use or enjoyment. (Motor cars are a border-line case. They are an article of current use to the private owner, but when used as a hackney carriage for the purpose of returning an income to the owner they represent a capital asset, falling under the definition of capital goods.)

Goods, Current.—Capital goods and consumer goods currently produced as distinct from old stocks of goods representing the production of a period more or less recently passed.

Gold Standard.—

1. *Full*, used to indicate money system under which gold is freely interchangeable with money at the Central Bank at prices fixed by law for purchase and for sale.
2. *International*, used to indicate money system under which gold is freely exchangeable for money at the Central Bank at a fixed price, but not freely obtainable at the Central Bank at a fixed price in money except when the gold is required for export.

H

Hoarding.—Laying up a store without intention to use the things stored.

I

Idle Bank Money: Idle Deposit Money: Idle Deposits.—Bank deposits not utilised in effecting payments (include therefore Time and Notice Deposits, which see).

Import of Capital.—*See under* C.

Income, Current.—Income in respect of current period as distinct from a period more or less recently passed.

INCOME, SURPLUS.—Income available for investment (which see).

INCOME OF INDIVIDUAL.—Amount received by individual in respect of a given period :

(*a*) For work done or services rendered.

(*b*) As participant in the profit of enterprise (shareholder, partner, sole owner of enterprise).

(*c*) As owner for having given to others the use of capital assets owned (interest, royalties, rent).

INFLATION.—Monetary process which involves expansion of the volume of money in relation to goods and services to be absorbed, with resultant depreciation of money in terms of goods; in other words, a rise in the price level of goods and services.

INVESTMENT (*see also* CAPITAL ASSETS).—

1. Utilisation of money in the acquisition of other types of capital assets.
2. The capital assets acquired.

INVISIBLE EXPORTS.—Current transactions other than export of goods—including gold—between interests in a country and interests abroad, involving receipt of payment by the former as if exports of goods had taken place from that country. (Payments receivable for freight, insurance premiums, banking commissions, remittances from abroad for maintenance of dependants, expenditure by visitors from abroad, etc.)

INVISIBLE IMPORTS.—Current transactions other than imports of goods—including gold—between interests in a country and interests abroad, involving the making of payments by the former as if imports of goods had taken place. (Sums payable for freights, insurance premiums, banking commissions, payments for upkeep of dependants resident abroad, expenditure when travelling abroad, etc.)

L

LIQUID ASSETS.—*See under* A.

LIQUID RESERVES.—*See under* R.

LIQUID RESOURCES.—*See under* R.

M

MANAGED CURRENCY.—*See under* C.

MEANS OF PRODUCTION.—Principal assets (as distinct from accessories) needful for carrying on the processes of production of commodities and the processes involved in the supply of the services of enterprise.

MONEY.—Collective term for currency, specie and bank deposits (cash and bank money).

MONEY, BANK.—*See under* B.

MONEY, CHEQUE.—*See under* C.

N

NOTICE DEPOSITS.—*See under* D.

P

PRODUCTION, UNBALANCED.—Production of commodities and provision of the services of enterprise without organised and coordinated attempt to gauge the factors bearing upon demand in general and their probable repercussions upon the distribution of demand over the various groups of commodities and services, with consequent failure to effect, betimes, necessary adjustments in volume made available.

PROFIT OF ENTERPRISE.—Amount by which aggregate sum realised or to be realised in respect of goods or services supplied by enterprise during a given period exceeds the aggregate sum of the expenditure incurred and to be incurred in the process of supplying these goods and services. The expenditure includes payment or provision for payment of interest on indebtedness, if any, and necessary provision, even if not actually expended or to be promptly expended, for the maintenance of the enterprise and its processes at required efficiency.

PURCHASING POWER.—

1. Property of being readily exchangeable for goods ; for instance, money, based on assets having intrinsic value, normally possesses purchasing power.
2. Assets which possess this property in special degree (bank deposits and other forms of money, also gold). The owner of such assets is said to possess purchasing power.
3. When used in reference to money or to gold : volume of goods obtainable for given quantity of money or of gold at given time. Comparison of purchasing power of money, or of gold, at different times is usually made by means of index numbers showing variations in the price level of goods in terms of money, or of gold as the case may be, which, inverted, afford the index of the purchasing power of money or of gold, in terms of goods.

PURCHASING POWER, IMMEDIATELY AVAILABLE.—Money.

PURCHASING POWER, POTENTIAL.—Assets readily convertible into money.

R

REFLATION.—Presupposes previous deflation and denotes policy aiming at modification of relationship between money and goods in the sense of raising the money value of goods (decreasing the value of money in terms of goods) above the existing level.

REPATRIATION OF CAPITAL.—Action of capitalists in a country involving acquisition by them of assets in their own country in exchange for foreign assets acquired at some previous time and now disposed of to foreign capitalists.

Reserves (of Enterprise).—

1. *Real:* amount by which appraised value of assets exceeds real liabilities, including capital.
2. *Nominal or book:* amount by which balance sheet (book) value of assets exceeds real liabilities, including capital.

Reserves, Cash.—*See under* C.

Reserves, Hidden.—Reserves in so far as not revealed as such in balance sheet (difference between real and book reserves if former greater; if, on the other hand, book reserves are greater there are not only no hidden reserves but book reserves are not fully represented by assets).

Reserves, Liquid.—Reserves held in form of liquid resources (which see).

To determine extent, if any, to which reserves are held in liquid form the amount of the reserves is to be compared with any excess which may be shown to exist of liquid resources plus current assets over current liabilities. When this excess, if any, is equal to or greater than the amount of the reserves, the whole of the reserves are available in liquid form. If it is less, reserves are only to that extent represented by liquid resources.

Reserves of the Banking System.—Cash held plus bankers' deposits at Bank of England owned by deposit banks.

Resources, Liquid.—Collective term, used in this book to denote the aggregate of the following items amongst the assets of enterprise: cash, credit balances at banks and marketable securities.

Revaluation.—Raising the price in terms of units of money of a country legally fixed for purchase of gold by the Central Bank or central money authority. This involves reduction of the gold content of the unit of the currency if that unit is a gold coin or a fixed quantity of gold.

S

Saving.—Abstention on the part of individuals from spending all or any part of their income upon goods or services, for current use, consumption or enjoyment.

Securities.—Documents representing evidence of participation in share capital of enterprise or of loan made to enterprise or to other categories of debtors, including governments, public authorities, etc., at home or abroad.

Security, Collateral.—*See under* C.

Self-liquidating Credit.—*See under* C.

Services of Enterprise.—Services supplied for gain by enterprise as distinct from services essentially individual. Services of enterprise include supply of gas and electricity, catering, transport, banking, insurance, etc.

SERVICES OF INDIVIDUALS.—Services supplied for gain by individuals as distinct from others essentially belonging to the sphere of enterprise as a collective unit. Individual services include manual labour, domestic, professional, clerical services, etc. Educational services in the collective form of schools are a service of enterprise, but teaching is a professional service performed by individuals.

SPECIE.—Coin as distinguished from paper money.

SURPLUS INCOME.—*See under* I.

T

TIME DEPOSITS.—*See under* D.

TRADE CYCLES.—Recurrent succession, at more or less irregular intervals, of periods of depression and recovery in economic activity.

TREND, CYCLICAL.—*See under* C.

TURNOVER.—Term used in this book to convey notion of changes of ownership generally. Active turnover would therefore mean frequent changes of hands, or a large volume or amount changing hands.

Where accompanied by indication of type or group of assets turned over it refers to aggregate in money value of the changes of hands unless otherwise stated.

Thus " turnover in securities " would apply to the aggregate money value of the securities which had changed hands. If it were desired to refer to quantities turned over, this would be expressly stated.

TURNOVER, VELOCITY OF.—*See under* V.

U

UNBALANCED PRODUCTION.—*See under* P.

V

VELOCITY OF TURNOVER.—Term used in connection with active deposits (current accounts) in the banking system, or with active money in general, *i.e.* currency and specie in circulation plus current accounts.

When it applies to active money in general, it denotes the rate at which the average total of this active money in existence during a given period changes hands, expressed in number of times per annum. That rate is arrived at by dividing the estimate of the aggregate of all payments effected by means of the active money during the given period, by the average total of the active money outstanding during that period, and then converting the ratio found to an annual basis.

When the term applies to active deposits, " current accounts in the banking system " is to be substituted in the above definition for " active money ".

W

WEALTH.—

1. *Of Individual :* Abundance of possessions.
2. *Of Community :* Productivity of soil and subsoil and economic result of human productive energy engaged on behalf of the community.

   Thus the product of economic activity of members of foreign communities, in so far as it is devoted to meeting obligations resulting from past indebtedness to the community concerned, is to be included. On the other hand, the effort spent within that community upon production to meet obligations resulting from past indebtedness to others outside must be deducted.

   It follows that a community is termed wealthy when its soil is prolific, the character and volume of the output of commodities per member is high and goods are due it, on balance, from abroad in substantial volume in respect of past financial relationships.

WORKING CAPITAL.—*See under* C.

THE END

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